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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 thirtieth 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 12 June to 7 July 2000, 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 the UNCITRAL *Legislative Guide on Privately Financed Infrastructure Projects*, the Summary Records of the United Nations Commission on International Trade Law for meetings devoted to the preparation of the draft Convention on Assignment of Receivables, the bibliography of recent writings related to the Commission's work, a list of documents before the thirty-third session and a list of documents relating to the work of the Commission reproduced in the previous volumes of the *Yearbook*.

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

Volume	*Years covered*	*United Nations publication Sales No.*
I	1968-1970	E.71.V.1
II	1971	E.72.V.4
III	1972	E.73.V.6
III Suppl.	1972	E.73.V.9
IV	1973	E.74.V.3
V	1974	E.75.V.2
VI	1975	E.76.V.5
VII	1976	E.77.V.1
VIII	1977	E.78.V.7
IX	1978	E.80.V.8
X	1979	E.81.V.2
XI	1980	E.81.V.8
XII	1981	E.82.V.6
XIII	1982	E.84.V.5
XIV	1983	E.85.V.3
XV	1984	E.86.V.2
XVI	1985	E.87.V.4
XVII	1986	E.88.V.4
XVIII	1987	E.89.V.4
XIX	1988	E.89.V.8
XX	1989	E.90.V.9
XXI	1990	E.91.V.6
XXII	1991	E.93.V.2
XXIII	1992	E.94.V.7
XXIV	1993	E.94.V.16
XXV	1994	E.95.V.20
XXVI	1995	E.96.V.8
XXVII	1996	E.98.V.7
XXVIII	1997	E.99.V.6
XXIX	1998	E.99.V.12
XXX	1999	E.00.V.9

Part One

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

THE THIRTY-THIRD SESSION (2000)

A. Report of the United Nations Commission on International Trade Law on the work of its thirty-third session

(New York, 12 June-7 July 2000) (A/55/17) [Original: English]

CONTENTS

I. INTRODUCTION

1. The present report of the United Nations Commission on International Trade Law covers the Commission's thirty-third session, held in New York from 12 June to 7 July 2000.

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-third session on 12 June 2000. The Under-Secretary-General for Legal Affairs, the Legal Counsel, opened the session.

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 current 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) and United States of America (2004).

5. With the exception of Kenya and Uganda, all the members of the Commission were represented at the session.

6. The session was attended by observers from the following States: Angola, Bangladesh, Belarus, Bolivia, Canada, Costa Rica, Côte d'Ivoire, Croatia, Cuba, Czech Republic, Holy See, Indonesia, Ireland, Israel, Kuwait, Morocco, Myanmar, Peru, Philippines, Poland, Portugal, Republic of Korea, Saudi Arabia, Sweden, Switzerland and Venezuela.

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

(a) United Nations system: Economic Commission for Europe; World Bank; International Monetary Fund.

(b) Intergovernmental organizations: Asian Clearing Union; Asian Development Bank; East African Cooperation Secretariat; European Union; Hague Conference on Private International Law; Inter-American Development Bank; International Institute for the Unification of Private Law.

(c) International non-governmental organizations invited by the Commission: Arab Association for International Arbitration; Arab Society of Certified Accountants; Association of the Bar of the City of New York; Cairo Regional Centre for International Commercial Arbitration;

[1] Pursuant to General Assembly resolution 2205 (XXI), the members of the Commission are elected for a term of six years. Of the current membership, 17 were elected by the General Assembly at its forty-ninth session, on 28 November 1994 (decision 49/315), and 19 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.

Chartered Institute of Arbitrators; Commercial Finance Association; Council of Legal Education; Europafactoring; European Banking Federation; European Lawyers' Union; Factors Chain International; Financial Markets Lawyers Group; Group of Thirty; International Association of Lawyers; International Association of Ports and Harbours; International Bar Association; International Chamber of Commerce; International Council for Commercial Arbitration; International Federation of Commercial Arbitration Institutions; International Federation of Insolvency Professionals (INSOL International); International Maritime Committee; International Swaps and Derivatives Association; International Women's Insolvency and Restructuring Confederation; 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 current session had accepted the invitation to take part in the meetings. Being aware that it was crucial for the quality of texts formulated by the Commission that relevant non-governmental organizations should participate in the sessions of the Commission and its working groups, the Commission requested the secretariat to continue to invite such organizations to its sessions based on their particular qualifications.

C. Election of officers[2]

9. The Commission elected the following officers:

Chairman:	Mr. Jeffrey CHAN WAH TECK (Singapore)
Vice-Chairmen:	Mr. Aly GAMLEDIN Awad (Egypt) Mr. Jorge ROBERTO MARADIAGA (Honduras) Ms. Victoria GAVRILESCU (Romania)
Rapporteur:	Mr. David MORÁN BOVIO (Spain)

D. Agenda

10. The agenda of the session, as adopted by the Commission at its 676th meeting, on 12 June 2000, was as follows:

1. Opening of the session.
2. Election of officers.
3. Adoption of the agenda.
4. Draft convention on assignment of receivables.
5. Draft legislative guide on privately financed infrastructure projects.
6. Electronic commerce.
7. Insolvency.
8. Settlement of commercial disputes.
9. Monitoring implementation of the 1958 New York Convention.
10. Case law on UNCITRAL texts (CLOUT).
11. Transport law: progress report on the gathering of information.
12. Endorsement of texts of other organizations: Incoterms 2000, ISP98, URCB.
13. Training and technical assistance.
14. Status and promotion of UNCITRAL legal texts.
15. General Assembly resolutions on the work of the Commission.
16. Coordination and cooperation.
17. Other business.
18. Date and place of future meetings.
19. Adoption of the report of the Commission.

E. Adoption of the report

11. At its 710th meeting, on 7 July 2000, the Commission adopted the present report by consensus.

III. DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES

A. Title and preamble

12. The Commission decided to postpone discussion of the title and the preamble until it had had a chance to consider the scope of the draft convention (see paras. 181-183).

B. Consideration of draft articles

CHAPTER I. SCOPE OF APPLICATION

Article 1. Scope of application

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

"1. This Convention applies to:

"*(a)* Assignments of international receivables and to international assignments of receivables as defined in this chapter, if, at the time of the conclusion of the contract of assignment, the assignor is located in a Contracting State;

"*(b)* Subsequent assignments provided that any prior assignment is governed by this Convention; and

[2]The election of the Chairman took place at the 676th meeting, on 12 June 2000, the election of the Vice-Chairmen at the 694th and 697th meetings, on 23 and 26 June 2000, respectively, and the election of the Rapporteur at the 687th meeting, on 19 June 2000. 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/72/16), 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)).

"*(c)* Subsequent assignments that are governed by this Convention under subparagraph *(a)* of this paragraph, notwithstanding that any prior assignment is not governed by this Convention.

"2. This Convention does not affect the rights and obligations of the debtor unless the debtor is located in a Contracting State or the law governing the receivable is the law of a Contracting State.

"[3. The provisions of chapter V 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. However, those provisions do not apply if a State makes a declaration under article 37.]

"4. The annex to this Convention applies in a Contracting State which has made a declaration under article 40."

Paragraph 1

14. The suggestion was made that subparagraph *(b)* should be revised to require for a subsequent assignment, as subparagraph *(a)* did for an initial assignment, that the assignor be located in a contracting State. It was stated that, unless the assignor in a subsequent assignment was located in a contracting State, the rules of the convention could not apply to a dispute with a third party arising in the assignor's location; and the convention could inadvertently apply to an assignment even if the assignor, the assignee and the debtor were located in a non-contracting State. The suggestion was objected to. It was observed that such an approach would be inconsistent with the principle of continuatio juris, which was reflected in subparagraph *(a)* and under which, if the initial assignment was covered by the convention, any subsequent assignment would also be covered.

15. While some concern was expressed that subparagraph *(c)* might be inconsistent with the principle of continuatio juris reflected in subparagraph *(b)*, it was widely felt that it appropriately provided that the convention applied to a subsequent assignment, which met the conditions of subparagraph *(a)*. In that connection, the view was expressed that the assignment addressed in subparagraph *(c)* was not really a third type of assignment, as suggested by the present wording, but rather a negation of a possible limitation that might otherwise apply with respect to assignments meeting the requirements of subparagraph *(a)*. It was, therefore, suggested that subparagraph *(c)* should be recast as a new paragraph 2 to read: "This Convention applies to a subsequent assignment that is described in paragraph 1 *(a)* of this article notwithstanding that this Convention did not apply to any prior assignment of the same receivable". Subject to that change, the Commission approved the substance of paragraph 1 and referred it to the drafting group.

Paragraph 2

16. It was noted that, in order to enhance certainty with respect to the application of the convention, paragraph 2 should specify the time when the debtor needed to be located in a contracting State or a receivable needed to be governed by the law of a contracting State for the debtor-related provisions of the convention to apply. It was also noted that reference to the time of the conclusion of the original contract would be preferable from a debtor protection point of view, since the debtor could determine at the time it undertook the original obligation whether the convention would affect its legal position. It was also noted, however, that such an approach would inadvertently result in the assignor, the assignee and other third parties being unable to determine at the time of the assignment of a future receivable whether the convention would apply to the rights and obligations of the debtor. Despite that difficulty, which also arose in article 3 with respect to the determination of the internationality of a future receivable, the Commission decided that paragraph 2 should be revised to provide that the debtor should be located in a contracting State or the receivable should be governed by the law of a contracting State at the time of the conclusion of the original contract. The Commission approved the substance of paragraph 2 and referred the matter to the drafting group.

Paragraphs 3 and 4

17. The Commission decided to defer discussion of paragraph 3, which dealt with the scope of the private international law provisions contained in chapter V, until it had had a chance to consider chapter V. The Commission also decided that paragraph 4, which dealt with the application of the annex, should be considered at a later stage in the context of the discussion of article 40 and the annex.

Article 2. Assignment of receivables

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

"For the purposes of this Convention:

"*(a)* 'Assignment' means the transfer by agreement from one person ('assignor') to another person ('assignee') of the assignor's contractual right to payment of a monetary sum ('receivable') from a third person ('the debtor'). The creation of rights in receivables as security for indebtedness or other obligation is deemed to be a transfer;

"*(b)* In the case of an assignment by the initial or any other assignee ('subsequent assignment'), the person who makes that assignment is the assignor and the person to whom that assignment is made is the assignee."

Non-contractual receivables

19. Concern was expressed that, by referring to contractual receivables, subparagraph *(a)* was unnecessarily restrictive. It was pointed out that the assignment of non-contractual receivables, such as payment rights under tax reimbursement claims, was part of important financing practices that the draft convention should cover. Furthermore, it was said that a broader definition of receivables might avoid the difficulties that resulted from the varying interpretation given in different legal systems to the term

"contractual rights". In order to address that concern, the suggestion was made that subparagraph *(a)* should be revised to refer to non-contractual receivables or that, at least, States should be given an option to apply the convention to assignments of non-contractual receivables. The suggestion was objected to. It was pointed out that the draft convention had been prepared with contractual receivables in mind and that some of its provisions (e.g. provisions as to the defences and rights of set-off and as to the location of the debtor) might be ill-suited for non-contractual receivables. An effort to cover the assignment of non-contractual receivables would, therefore, require a careful review and adjustment of a number of provisions of the draft convention, which was considered non-productive at that late stage of the deliberations. After discussion, the Commission confirmed the decision of the Working Group on International Contract Practices to limit the scope of application of the convention to contractual receivables.

Parts of and undivided interests in receivables

20. The Commission noted that, while article 9 expressly validated partial assignments, partial assignments were not explicitly referred to in subparagraph *(a)* and that, as a result, uncertainty might arise as to whether the convention as a whole applied to partial assignments. In particular, it was noted that uncertainty might arise with regard to the legal position of the debtor in the case of a partial assignment (e.g. whether the debtor would be obliged to pay the assignee or the assignor). In view of the fact that partial assignments were involved in significant financing practices, the Commission decided that the matter should be explicitly addressed in subparagraph *(a)* and referred the matter to the drafting group. In the discussion, it was suggested that another possible approach to the problem might be to confine article 11 to assignments of whole receivables. The Commission postponed discussion of the legal position of the debtor in the case of a partial assignment until it had a chance to consider the debtor-related provisions of the draft convention (see paras. 173, 180 and 185).

21. The Commission noted that article 9 validated not only partial assignments of receivables, but also assignments of undivided interests in receivables. It was generally agreed that appropriate reference to assignments of undivided interests in receivables should also be made in article 2 so as to make it clear that the convention as a whole was also applicable to such assignments.

Non-monetary performance rights

22. The Commission decided that the assignment of non-monetary performance rights arising out of the original contract (such as the right to performance, the right to declare the contract avoided) should not be covered by the convention. It was agreed that assignments of such non-monetary performance rights were not frequent in practice and that, therefore, their inclusion in the scope of the convention was not necessary. It was also pointed out that the draft convention had been prepared essentially with assignment of monetary rights in mind and that the inclusion of other performance rights might require adjustments in various provisions. Furthermore, it was felt that, while the transfer of security or supporting rights related to the receivable was appropriately addressed in the draft convention (see article 12), other rights, such as the right to terminate a contract, might be regarded as eminently personal rights that should not be automatically transferred to the assignee with the receivable.

Statutory assignability

23. The Commission noted that assignments of receivables that were not assignable by law (other than those addressed in article 9) were not intended to be covered by the draft convention and considered the question whether that understanding should be explicitly expressed in article 2. Noting that the matter related to the effectiveness of the assignment, rather than to the scope of the convention, the Commission decided that it should be considered in connection with article 9 (see para. 131).

Unilateral assignments

24. The Commission decided that unilateral assignments (i.e. assignments made but not yet accepted by the assignee) should not be addressed in the draft convention. It was widely felt that such assignments were rare in practice and that, therefore, there was no need to address them in the draft convention.

Article 3. Internationality

25. The text of draft article 3 as considered by the Commission was as follows:

> "A receivable is international if, at the time of the conclusion of the original contract, the assignor and the debtor are located in different States. An assignment is international if, at the time of the conclusion of the contract of assignment, the assignor and the assignee are located in different States."

26. The Commission approved the substance of article 3 and referred it to the drafting group.

Article 4. Exclusions

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

"1. This Convention does not apply to assignments:

"*(a)* Made to an individual for his or her personal, family or household purposes;

"*(b)* To the extent made by the delivery of a negotiable instrument, with any necessary endorsement;

"*(c)* Made as part of the sale, or change in the ownership or the legal status, of the business out of which the assigned receivables arose.

"[2. This Convention does not apply to assignments listed in a declaration made under article 39 by the State in which the assignor is located, or with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, by the State in which the debtor is located.]"

Paragraph 1 (a)

28. It was noted that the convention was intendgd to cover assignments of commercial or consumer receivables for commercial purposes, but not assignments for consumer purposes (irrespective of whether the receivables were commercial or non-commercial). With that understanding, the Commission approved the substance of subparagraph *(a)* and referred it to the drafting group.

Paragraph 1 (b)

29. It was noted that subparagraph *(b)* was intended to exclude from the scope of the convention transfers of negotiable instruments, whether made by mere delivery or by delivery and endorsement. It was also noted that, when a receivable served as a basis for issuing a negotiable instrument and then both the negotiable instrument and the claim were transferred, the transfer of the negotiable instrument was not covered by the draft convention while the transfer of the receivable by way of an assignment was to be covered. In that connection, a suggestion was made to delete in subparagraph *(b)* the expression "with any necessary endorsement" as it might lead to a misunderstanding that a transfer of a negotiable instrument by mere delivery was not excluded. The Commission approved the substance of subparagraph *(b)* and referred it to the drafting group.

30. The question was raised whether subparagraph *(b)* should exclude from the scope of application of the convention also transfers of dematerialized (i.e. electronic) securities held by an intermediary. The Commission took note of the question and decided to discuss it subsequently in the context of the broader discussion of the types of transaction to be included in or excluded from the scope of the convention (see para. 72). In addition, it was noted that dematerialized securities might call for special treatment as regards the law applicable to competing rights (article 24). It was also noted that the matter might be considered by the Hague Conference on Private International Law and, therefore, coordination and cooperation with the Hague Conference might become necessary (see paras. 177, 178 and 460).

Paragraph 1 (c)

31. The Commission approved the substance of subparagraph *(c)* and referred it to the drafting group.

Paragraph 2

32. It was noted that paragraph 2, allowing States to exclude further practices, appeared within square brackets pending final determination of the scope of the convention. The Commission postponed consideration of paragraph 2 until it had reached a final decision on the scope of the convention (see paras. 109 and 152).

Article 5. Limitations on [assignments of] receivables other than trade receivables

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

"[*Variant A*

"1. Articles 17, 18, 19, 20 and 22 do not affect the rights and obligations of the debtor in respect of a receivable other than a trade receivable except to the extent the debtor consents.

"2. Notwithstanding articles 11, paragraph 2, and 12, paragraph 3, an assignor who assigns a receivable other than a trade receivable is not liable to the debtor for breach of a limitation on assignment described in articles 11, paragraph 1, and 12, paragraph 2, and the breach shall have no effect.

"*Variant B*

"Articles 11 and 12 and section II of chapter IV apply only to assignments of trade receivables. With respect to assignments of receivables other than trade receivables, the matters addressed by these articles are to be settled in conformity with the law applicable by virtue of the rules of private international law.]"

34. While some support was expressed in favour of variant A, it was widely felt that an approach along the lines of variant B would be preferable since it would result in protecting the debtor more fully than variant A. It was stated that, if the assignment were to be effective as between the assignor and the assignee, as provided under variant A, the legal position of the debtor could, in certain legal systems, be negatively affected. The discussion focused on a revised version of variant B, as follows (see A/CN.9/472/Add.1, page 11):

"Unless the debtor consents, articles 11 and 12 apply only to assignments of trade receivables. With respect to assignments of receivables other than trade receivables, the matters addressed by these articles are to be settled in conformity with the law applicable by virtue of the rules of private international law."

35. This revised version of variant B was supplemented by the following definitions (see A/CN.9/472/Add.1, page 12):

"'Trade receivable' means a receivable arising under an original contract for the sale or lease of goods or the provision of services other than receivables arising under payments or securities settlement systems and receivables arising under financial contracts governed by netting agreements or used as collateral.

"'Payment or securities settlement system' means any contractual arrangement between three or more participants with common rules for the settlement of payment or security transfer orders, and of any related collateral, between the participants, whether or not supported by a central counter-party, settlement agent or clearing house.

"'Financial contract' means any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities

lending transaction, any deposit transaction and any other transaction similar to any transaction referred to above entered into in financial markets and any combination of the transactions mentioned above, and any collateral or credit support related to any transaction referred to above.

"'Netting agreement' means an agreement which provides for one or more of the following:

"*(a)* The net settlement of payments due in the same currency on the same date whether by novation or otherwise;

"*(b)* Upon the insolvency or other default by a party, the termination of all outstanding transactions at their replacement or fair market values, conversion of such sums into a single currency and netting into a single payment by one party to the other; and

"*(c)* The set-off of amounts calculated as contemplated by the preceding phrase *(b)* under two or more netting agreements."

36. Comparing the original and the revised version of variant B, general preference was expressed for the revised version. It was observed that the original version of variant B was unnecessarily broad in that it would inadvertently result in excluding from the scope of the convention the assignment of all receivables other than trade receivables. Unlike the original version of variant B, the revised version called for a more limited exclusion, since it referred only to articles 11 and 12, only for receivables from payment systems or financial netting agreements and only if the debtor did not consent to the assignment.

37. With regard to the particular formulation of the revised version of variant B, a number of views were expressed. One view was that the reference to consent by the debtor was meaningless, since anti-assignment clauses were routinely included in netting arrangements. Another view was that the reference to private international law might create uncertainty and should be deleted. In response, it was pointed out that, even if that reference were to be deleted, the result would be the same. As regards the definition of "trade receivable", it was observed that receivables from construction works should also be treated as trade receivables. It was also stated that it might be better to avoid defining "trade receivable" since the term was not universally understood in the same way (for remarks on the other definitions, see paras. 49-51).

38. While it was agreed that the revised version of variant B was more appropriate than variant A and the original version of variant B, the view was expressed that even the revised version of variant B did not go far enough in protecting the rights of debtors, for example, in financial netting agreements, since it relied on the existence of an anti-assignment clause and on the effect given to that clause by the law applicable outside the draft convention. It was stated that, if the applicable law recognized the validity of an assignment made in violation of an anti-assignment clause, the assignment would be effective and could fall within the ambit of the convention. As a result, for example, netting arrangements might be disrupted (e.g. because netting could be exercised by means other than set-off and, therefore, article 19 might not be sufficient in preserving netting rights). To the extent that the debtor would have a right of set-off and would be considered to be also a creditor, in the case of a conflict of priority, article 24 could apply and refer priority issues to the law of the assignor's location rather than, for example, to the more appropriate law of the location of the investment securities account. It was stated that consultation with the industry had led to the result that certain financial practices should be excluded from the scope of application of the convention altogether. In the place of article 5, language along the following lines was proposed for inclusion in articles 6 and 4:

"*Article 6 "Definitions and rules of interpretation*

"(x) (i) Except as provided in subparagraph (ii), a receivable is a contractual right to payment of a monetary sum, owed by a person (debtor) to an assignor, as:

"*(a)* Payment for goods sold or leased or for the provision of services [other than financial services];

"*(b)* Payment for industrial or other intellectual property sold or licensed;

"*(c)* Payment for a credit card transaction;

"*(d)* Repayment of a loan of money, regardless of the currency in which denominated; or

"*(e)* Reimbursement for the payment, pursuant to a guaranty, suretyship obligation [or other secondary obligation] of the debtor's obligation to a third party.

"(x) (ii) The following are not 'receivables':

"*(a)* Rights to payment arising from transactions on a regulated futures exchange;

"*(b)* Rights to payment arising from the sale, lease or loan of gold or other precious metals;

"*(c)* Rights to payment under a financial netting agreement;

"*(d)* Rights to payment under bank deposit relationships, including those arising under inter-bank payment systems;

"*(e)* Rights to payment from an insurer under an insurance contract, or from a reinsurer under a reinsurance contract;

"*(f)* Rights to payment for goods sold or leased to the extent that under the law of the State where the goods are located the goods are considered to be part of the real estate on which the goods are situated;

"*(g)* Drawing rights or rights to payment under a letter of credit or independent bank guarantee;

"*(h)* Rights to payment arising from foreign exchange contracts; or

"*(i)* Rights to payment arising from the sale or lending of investment securities, including repurchase agreements and rights to payment arising under investment securities settlement systems."

"*Article 4 "Exclusions and limitations on application of certain provisions*

"3. In the case of receivables described in subparagraphs *(d)* and *(e)* of article 6 (x) (i), articles 11 and 12 do not affect the rights and obligations of the debtor [or any guarantor, surety or other secondary obligor for the debtor] unless the debtor [or such guarantor, surety, or secondary obligor] otherwise consents."

39. The purpose of the proposal, it was explained, was essentially to refine the scope of application of the convention with a view to ensuring that it did not inadvertently disrupt certain financial practices for which not all provisions of the convention were well suited. It was observed that the proposal was based on a distinction between three categories of receivables, those to which all of the provisions of the convention would apply, those to which only some provisions would apply and those which would be excluded from the scope of application of the convention altogether. Moreover, it was explained that the list of exclusions was necessary since, even with an enumeration of practices covered, the convention could inadvertently apply to practices that were well regulated and that could even be disrupted if the convention were to apply.

40. There was general agreement in the Commission that certain practices needed to be treated differently. Differing views were expressed, however, as to whether those practices should be excluded from the scope of the convention as a whole or from the scope of articles 11 and 12 only. One view was that, if articles 11 and 12 did not apply, the effectiveness of assignments made despite anti-assignment clauses would be left to law applicable outside the convention. As a result, in most cases, the assignment would be ineffective and the convention would not apply. It was also stated that, while an approach based on lists would have the same result, it could not be preferred because it raised a number of problems. One problem was that an approach based on lists, rather than on a general rule, would run the risk of being incomplete or inconsistent and thus raise questions of interpretation. Another problem was that a list could soon become outdated, since international practice evolved rapidly and new types of receivables might develop that might not fit well into any of the categories listed in the proposal. In that event, questions would arise as to whether those new types of receivables would fall within or outside the scope of the convention. Yet another problem was that any list might inadvertently exclude new practices with regard to trade receivables, thus hampering their further development. Still another problem was that the lateness of the proposal did not allow delegates time for consultations with representatives of the relevant sectors of the industry, which became necessary as a result of the radical nature of the proposal.

41. Another view was that a qualified approach, such as the one mentioned above (see paras. 38 and 39), should be followed. Such an approach would enhance certainty in the application of the convention and increase the level of its acceptability to States and the relevant industry. It was stated that, for the reasons mentioned above (see para. 38), excluding certain practices from the scope of articles 11 and 12 only would not be sufficient to avoid undue interference with well-regulated and efficiently functioning practices. That result was said to be contrary to the main goal of the convention, which was to increase the availability of lower-cost credit. In addition, it was stated that the proposal did not raise a new issue, since the exact scope of the convention had been left open by the Working Group.

42. After discussion, the Commission postponed reaching a decision as to the proposed approach until it had completed its consideration of the practices listed in the proposal (see paras. 97-100). In order to accommodate some of the concerns expressed, the Commission agreed that the definition of "receivable" by way of a list of practices could, for the time being, be left aside. The Commission went on to consider in more detail the practices suggested to be excluded.

Subparagraph (a) *(Payment rights from regulated futures exchanges)*

43. It was stated that the reference to rights to payment arising from transactions on a regulated futures exchange was essentially intended to cover exchange trading of derivatives and commodities, which was well regulated and functioning under national law. In addition, it was observed that application of the convention to such practices could frustrate the legitimate expectations of parties and seriously disrupt existing markets. The suggestion was made that, for the same reasons, all exchange trading should be excluded. It was stated that such an approach would render any specific reference to exchange trading in precious metals and to foreign currency exchange trading unnecessary. In order to address the points made in the discussion, the proposal was reformulated as follows: "[rights to payment] [receivables] arising from transactions on a regulated exchange". It was observed that the bracketed language was being used pending determination by the Commission whether such an exclusionary approach would be followed and, if so, whether the list of exclusions would be made part of article 2 or article 4. In response to a question, it was stated that the reference to "exchange" was intended to encompass transactions made under the auspices of a regulated exchange (e.g. stock exchange, securities and commodities exchange) and not every regulated market.

Subparagraph (b) *(Rights to payment from the sale, lease or loan of gold or other precious metals and from foreign currency exchange transactions)*

44. It was explained that the proposed exclusions were based on considerations similar to those underlying the proposed exclusion of rights to payment arising from transactions on a regulated futures exchange. They were needed because the rules of the convention (e.g. articles 11 and 12) might not be entirely compatible or might even interfere with the functioning of regulated markets. It was also explained that, while precious metals and foreign currency were traded in exchanges, trading between individuals was also a practice that should be excluded, in particular in view of the need to control the transfer of such assets to off-shore parties.

45. Various objections were raised to the proposed exclusion, which it was felt would lead to an unnecessary and unjustified limitation of the scope of application of the convention. It was considered that the essential criterion for the exclusion should be the technique used for settlement and not the nature of the assets being traded. It was added that, as currently formulated, the proposed exclusion would encompass transactions involving the factoring of proceeds of the sale of gold and other metals that took place outside any regulated exchange, such as the sale of jewellery. After deliberation, it was tentatively agreed that the proposed exclusions should be reformulated and possibly combined with trading in a regulated exchange. As a result, subparagraph *(b)* of the proposed text (see para. 38) could be deleted and subparagraph *(h)* would relate only to foreign exchange contracts negotiated off a regulated exchange (see paras. 66-68).

Subparagraph (c) *(Rights to payment under financial netting agreements)*

46. The Commission generally agreed that the assignment of rights to payment under financial netting agreements should be excluded from the scope of application of the convention or of articles 11 and 12. It was widely felt that such practices functioned well under standard master agreements prevailing in practice (e.g. master netting agreements prepared by the International Swaps and Derivatives Association) and currently applicable law. In addition, it was stated that bringing the assignment of financial netting receivables into the scope of the convention would inadvertently result in disrupting such financial netting practices, since certain provisions of the draft convention would not work well for those practices (e.g. articles 11, 12, 19 and 24-26). Such a result was said to be contrary to the overall goal of the convention, which was to increase the availability of lower-cost credit with a view to facilitating the movement of goods and services across national borders. Moreover, it was observed that the exclusion of the application of articles 11 and 12 only would not be sufficient to protect parties to financial netting agreements, since it was based on the assumption that there would always be an anti-assignment clause and that that clause would be validated under law applicable outside the convention. In that connection, it was observed that, if an assignment was effective despite the fact that it was made in violation of an anti-assignment clause, the assignment could fall under the convention. As a result, the debtor's right to netting might be affected (article 19 referring to set-off might not cover all types of netting) and priority would be referred to the law of the assignor's location (instead of the more appropriate law of the location of the securities account).

47. With regard to the particular formulation of the exclusion of netting in financial agreements, a number of questions were raised. One question was whether payment rights arising both before and after close-out (i.e. termination) of the netting agreement were meant to be covered by the exclusion. In response, it was stated that all such rights to payment were intended to be covered. Another question was whether netting in non-financial agreements (e.g. in the airline or farming business) should also be excluded. While there was some support for the exclusion of such netting agreements, the prevailing view was that they should not be excluded, since such an approach might inadvertently result in excluding the assignment of certain trade receivables. It was suggested, however, that the application of articles 11 and 12, dealing with anti-assignment clauses, might be excluded with respect to such non-financial netting agreements. There was no sufficient support for that suggestion (for the continuation of the discussion, see para. 149).

48. The view was expressed that rights arising under inter-bank payment systems (referred to in subparagraph *(d)*) and rights arising from the sale or lending of investment securities or under investment securities settlement systems (referred to in subparagraph (i)) were closely related to netting agreements and should be listed together. In order to address the concerns expressed, subparagraph *(c)* of the proposed text (see para. 38) was reformulated as follows: "[Rights to payment] [Receivables] arising under financial contracts governed by netting agreements, except a [receivable] [right to payment] owed on the termination of all outstanding transactions". It was explained that only financial netting arrangements would be covered, while netting between industry participants would not be excluded (but might need to be treated differently in the context of article 20 so as to ensure that rights of set-off arising from transactions governed by netting arrangements would be preserved; see, however, para. 149). It was also stated that the assignment of receivables payable upon termination of a netting arrangement was not intended to be excluded, since in such a case there was no risk that the mutuality of netting arrangements would be disturbed.

Definitions

49. Support was expressed in favour of the definition of "netting agreement" (see para. 35). At the same time, a number of concerns were expressed. One concern was that the definition was too broad and might inadvertently result in excluding bilateral agreements between traders pooling credits and debits and settling mutual obligations by way of net payments, a result that was considered inappropriate. In response, it was observed that financial netting arrangements, whether multilateral or bilateral, should be excluded from the scope of the draft Convention. Another concern was that the reference to "set-off" might be inappropriate, since there was no universal understanding of that notion. Yet another concern was that the situation described in subparagraph *(b)* of the definition of "netting agreement" did not involve a genuine netting arrangement and should be deleted.

50. Support was also expressed in favour of the definition of "financial contract" (see para. 35). It was suggested, however, that the reference to payment rights from deposit accounts should be deleted, since specific reference was made in the proposed list of exclusions to payment rights from deposit accounts (see para. 38 and para. (x) (ii) *(d)* of the proposed text). It was also suggested that the reference to collateral or credit support arrangements should be deleted, since such arrangements did not constitute a necessary element for the definition of "financial contract". It was stated, however, that collateral and credit support arrangements were an important part of financial contracts,

which affected the overall cost of the financing made available and should, therefore, be explicitly mentioned either in the definition of "financial contract" or in the definition of "netting agreement". In response, it was observed that, while the importance of collateral and credit support arrangements could not be denied, they did not form part of the definition of either "netting agreement" or "financial contract". It was also stated that referring to collateral arrangements in the definitions of "financial contract" or "netting agreement" could inadvertently result in the exclusion of an assignment of receivables made by a business to secure a bank loan. It was tentatively agreed that the reference to collateral and credit support arrangements in the definition of "financial contract" should be deleted (see also para. 74).

51. The Commission also considered the definition of "payment or securities settlement system" (see para. 35). It was stated that it was important to clarify that three or more participants were required for an inter-bank payment or securities settlement arrangement to qualify as a "system" and be excluded from the scope of the convention. The view was expressed that that matter could be clarified in a commentary to the convention. It was observed, however, that in some countries such payment systems could be established by two correspondent banks. After discussion, the Commission tentatively decided that a definition of payment and securities settlement systems was not necessary (for the continuation of the discussion, see para. 71).

Subparagraph (d) *(Rights to payment under bank deposit relationships, including those arising under inter-bank payment systems)*

52. It was stated that, with respect to the assignment of receivables arising from deposit accounts and inter-bank payment systems, the convention would not always lead to desirable results and that, in any case, those receivables were regulated by law and by contract in the light of the specific needs of the relevant practices. Some support was expressed in favour of leaving assignments of such receivables within the ambit of the convention (as had been the view in the Working Group), since they were frequent and it was desirable that they should benefit from the harmonized regime of the draft convention. It was observed that, if any special treatment of those receivables was needed (e.g. as regards priority and location), that should be addressed in the context of the relevant draft articles. However, the prevailing view was that those receivables should be excluded, since it was preferable to leave the issue of their assignability and the effects of assignment to the regulation outside the convention. It was stated that interference by the convention in non-assignment clauses in bank deposits might cause misgivings in that industry and might have a negative effect on the acceptability of the convention.

53. There was support in the Commission for excluding the assignment of receivables arising from inter-bank payment systems (whether from the draft convention as a whole or only from articles 11 and 12 remained an open question; see paras. 97-100). However, since those relationships, whether multilateral or bilateral, contained elements of netting, it was suggested that that exclusion should be incorporated into and consolidated with the exclusion of rights to payment under a financial netting agreement (see paras. 46-48). In order to meet some of the concerns expressed, the second part of subparagraph *(d)* of the proposed exclusion (see para. 38 and para. (x) (ii) *(d)* of the proposed text) was reformulated thus: "[Rights to payment] [Receivables] arising under inter-bank payment systems or securities settlement systems". In response to the query as to a possible inconsistency with the reformulated version of the exclusion of financial netting arrangements (see para. 48), it was observed that inter-bank payment or securities settlement systems operated within or outside netting arrangements. It was also stated that, in the case of inter-bank payment and securities settlement systems, the assignment of the payment obligation outstanding on the termination of a netting arrangement should be excluded, since there was no market in financing such close-out payment rights.

54. In the discussion, the question was raised as to whether the facilitation by the convention of assignments of financial deposits might run counter to the provisions of law designed to prevent money-laundering. It was noted in response that that was not the case, because any assignments of receivables under the convention would remain subject to any mandatory provisions concerning money-laundering.

Subparagraph (e) *(Rights to payment from an insurer under an insurance contract, or from a reinsurer under a reinsurance contract)*

55. It was pointed out that the insurance market was regulated in great detail (by contract and statute) and that the draft convention introduced provisions that might not produce the desired results or might even interfere with the contractual and statutory provisions governing those contracts. In addition, there existed many forms of insurance that were subject to different policy considerations and expectations of the parties and it was difficult to make sure that provisions of the draft convention would not present an undesirable interference with them.

56. The proposal to exclude insurance practices was objected to on the ground that it was desirable to place receivables from insurance contracts on a certain and internationally harmonized legal footing. Such receivables (from different types of insurance contract such as casualty, health, pension, credit or liability insurance) were frequently assigned and were also frequently part of cross-border financing operations, such as factoring. Those operations were developing and it was desirable to facilitate them and reduce their costs and risks by means of the convention. After discussion, the proposal to exclude the assignment of insurance receivables did not obtain sufficient support and the Commission decided not to single out insurance or reinsurance receivables as receivables to be excluded from the scope of the convention as a whole.

Subparagraph (f) *(Rights to payment for goods sold or leased that become part of real estate)*

57. It was widely felt that the assignment of receivables arising from the sale or lease of goods should not be excluded, even if the goods had temporarily become part of

real estate. It was stated that the exclusion of the assignment of such trade receivables from the scope of the convention would significantly reduce its usefulness and undermine its chances for wide adoption. It was also observed that such an exclusion would create uncertainty with regard to the application of the draft convention in view of the divergent approaches taken in various legal systems as to the conditions required for movable goods to become part of real estate.

58. The discussion focused on a reformulated version of subparagraph *(f)*, which was aimed at excluding the assignment of: "[Rights to payment] [Receivables] arising from the sale or lease of real estate". Support was expressed for the reformulated version of subparagraph *(f)*, which would result in avoiding the exclusion of the assignment of trade receivables, without creating undue interference with national law on real estate rights.

59. It was pointed out, however, that the assignment of receivables arising from the lease of real estate should not be excluded. In response, it was observed that it would be counter-productive to attempt to draw a distinction between sales and leases, since leases often had attributes of a sale (e.g. long-term leases with an option to buy) and, in many legal systems, were treated in the same way as sales.

60. On the other hand, it was observed that, while the assignment of receivables arising from leases of real estate could be included in the scope of the convention, it was most important to exclude receivables secured by a mortgage in real estate so as to avoid interfering with national law on the transfer of mortgages in general and on securitization of mortgages in particular. In that connection, a note of caution was struck that the usefulness of the convention would be severely reduced if the assignment of trade receivables (arising from the supply of goods, construction or services) were to be excluded on the sole ground that they happened to be secured by real estate. It was pointed out that commercial and, in particular, construction companies regularly relied on the assignment of receivables secured by a mortgage in real estate or construction sites for obtaining financing. It was also stated that it would be a strange result for the convention not to cover a global assignment of receivables by a commercial entity merely because that entity (assignor) or the debtor or a third party gave a mortgage as an additional security. It was pointed out that excluding such a global assignment would create uncertainty as to the application of the convention and might lead to inconsistent results (e.g. a conflict arising before a mortgage was given would be covered but not a conflict arising after the mortgage was given).

61. In addition, it was stated that the concern expressed with regard to the effect an assignment of receivables could have on security rights in real estate could be addressed by means of a private international law rule that would refer conflicts of priority between an assignee under the convention and a holder of an interest in real estate with a right in the assigned receivable to the law of the location of the real estate. The following wording was proposed:

> "If the assigned receivable arises from the sale or lease of an interest in land or is secured by such an interest, the rights of the assignee are subject to any competing rights of a person who holds an interest in the land under the law of the State in which the land is situated".

Support was expressed for that proposal. It was stated that the legal analysis underlying the proposal was sound and addressed all relevant issues. In particular, it was pointed out that, if no conflict arose with a holder of a right in real estate under national law and there was no statutory limitation on the assignment of real estate receivables (a matter that might be explicitly addressed in article 9; see para. 131), national real estate markets would not be affected by the convention. In addition, it was observed that the draft convention dealt with the assignment of receivables and did not include any rules that could undermine national real estate markets. It was pointed out, in particular, that article 12 was sufficient in referring to national law issues, such as the distinction between an accessory and an independent right, rights of the debtor as against the assignor and the form of transfer of a security right, whether in real estate or in movable property.

62. However, the view was expressed that the proposed text might not be sufficient to ensure that national real estate markets would not be disrupted. Under such an approach, matters other than priority (and form, which was left to national law by virtue of article 12, para. 5) might fall within the ambit of the convention. It was, therefore, suggested that a broader private international law rule would be necessary. The following language was proposed for inclusion in article 25: "Where the assignment would transfer or create an interest in land or a receivable arising from such an interest, the law of the State in which the land is located will govern the matters specified in article 24". After deliberation, the proposal was modified to read as follows:

> "Where a receivable arises from an interest in land, or where the assignment of a receivable, or any associated transaction, would create or transfer an interest in land, all matters pertaining to that interest in land will be governed by the law of the State in which that land is located for the purposes of this Convention".

Support was expressed for the proposed text. It was stated that an approach based on a special regime to be incorporated in draft article 25 would better address all the concerns expressed. It was observed, however, that there was no real difference between that proposal and the proposal mentioned above (see para. 61), since, under the latter proposal, the law of the assignor's location applied only if its application would not result in any interference with the law of the State in which the real estate was located.

63. As an alternative to the above-mentioned proposals to deal with the matter by way of a limited exclusion in article 24 or in article 25, it was proposed that, in order to avoid interfering with national mortgage markets, an outright exclusion in article 4, paragraph 1, could relate only to "receivables arising from the sale or lease of real estate that are secured by a mortgage in such real estate". In addition, it was stated that, if the Commission were not able to reach agreement on such an exclusion, an approach based on article 4, paragraph 2, could be considered. Concern was expressed, however, that article 4, paragraph 2, allowing States to exclude an unlimited number of practices, would not be conducive to the uniformity sought to be achieved through the convention.

64. After deliberation, the Commission suspended consideration of the matter to allow time for consultations (for the continuation of the discussion, see paras. 75-87).

Subparagraph (g) *(Drawing rights or rights to payment under a letter of credit or independent bank guarantee)*

65. The Commission agreed that the assignment of receivables arising from letters of credit or independent guarantees (either as rights to claim payment or rights to receive payment after a valid claim had been made) should not be governed by the convention. It was widely felt that the assignment of such receivables gave rise to special considerations that were dealt with by special non-legislative and legislative texts, including the Uniform Customs and Practices (UCP500), the International Standby Practices (ISP98) and the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (General Assembly resolution 50/48, annex, "the Guarantees and Stand-by Convention").

Subparagraph (h) *(Rights to payment arising from foreign exchange contracts)*

66. The Commission recalled that foreign exchange contracts would be excluded by the convention insofar as they took place under the auspices of a regulated exchange (see subpara. *(a)* and para. 43) or involved netting arrangements (see subpara. *(c)* and paras. 46-48). The discussion focused on foreign exchange contracts that would not fall under subparagraph *(a)* or subparagraph *(c)* of the proposed list of exclusions.

67. The view was expressed that the exclusions under subparagraphs *(a)* and *(c)* were not sufficient since there were significant practices relating to foreign exchange contracts that took place outside a regulated exchange and were not subject to master netting agreements. It was also stated that, in such situations, financing institutions would rely on statutory rights of set-off, the preservation of which was crucial for controlling the credit risk and thus the cost of a transaction. It was also stated that it was equally essential for financial institutions to be able to rely on non-assignment clauses against possible assignees of the proceeds of foreign exchange transactions. The application of articles 11 and 12 could thus inadvertently result in an increased exposure of the financial institutions to the risk of default by their clients, which would lead to an increase in the financial cost of those transactions. Another argument put forward in support of the proposed exclusion was that foreign exchange transactions were in many countries subject to special regulation by domestic monetary authorities and that the exercise of those regulatory functions should not be hindered by the convention. Monetary regulations sometimes included restrictions on the assignability of the proceeds of foreign exchange transactions for the purpose of controlling cross-border currency flows.

68. The Commission took note of those concerns. Nevertheless, it considered that there was no compelling reason to exclude those residual foreign exchange transactions from the scope of application of the convention. Financial institutions that wished to avoid the application of the convention to their foreign exchange transactions remained free to use netting agreements for those transactions, thereby qualifying for exclusion under the appropriate provision. In addition, it was widely felt that, to the extent that statutory regulations restricted the assignability of receivables arising under foreign exchange contracts, they would remain unaffected by the convention as a whole and articles 11 and 12 in particular. Moreover, it was generally felt that article 20 was sufficient to preserve the debtor's rights of set-off. After discussion, the Commission decided that subparagraph *(h)* should be deleted.

Subparagraph (i) *(Rights to payment arising from the sale or lending of investment securities, including repurchase agreements and rights to payment arising under investment securities settlement systems)*

69. It was recalled that rights to payment arising under investment securities settlement systems would be covered under subparagraph *(d)* as revised (see para. 53), while the sale or lending of investment securities would not be covered by the exclusions with respect to netting arrangements and transactions on a regulated exchange. Support was expressed for the exclusion. It was stated that investment securities were sold, lent or traded pursuant to repurchase agreements in well-established and regulated markets and that the convention (e.g. the rules on representations, set-off and priority) might have a disruptive effect on those markets. In response, it was argued that the fact that those transactions were subject to regulation by national law was not sufficient to justify their exclusion from the scope of the convention, since the convention would not affect any statutory limitations on assignment. It was therefore suggested that, if necessary, States could make use of the right recognized in article 4, paragraph 2, to exclude certain practices by making a declaration under article 39. It was said in reply that, to the extent any practices should be excluded from the convention, it would be preferable to exclude them explicitly in article 4, paragraph 1, and not by a unilateral declaration by a State pursuant to articles 4, paragraph 2, and 39, since such an approach would not advance uniformity and might create uncertainty as to the application of the convention. After discussion, pending final determination of the question whether exclusions should relate to the convention as a whole or to articles 11 and 12 only, the Commission tentatively decided that sales and loans of investment securities should be excluded (see also para. 72).

Revised consolidated list of exclusions

70. Subsequently, the Commission reviewed the results of its consideration of the types of receivables that should be excluded from the convention. The Commission did so on the basis of a draft prepared by an informal ad hoc group for inclusion in article 4, paragraph 1, which read as follows:

"[The Convention does not apply to]:

"*(a)* Receivables arising from transactions on a regulated exchange;

"*(b)* Receivables arising under financial contracts governed by netting arrangements, except a receivable owed on the termination of all outstanding transactions;

"*(c)* Receivables arising from bank deposits;

"*(d)* Receivables arising under inter-bank payment systems or investment securities settlement systems;

"*(e)* Receivables under a letter of credit or independent bank guarantee;

"*(f)* Receivables arising from the sale or loan of investment securities."

71. Recalling its earlier discussion on the definition of "payment and securities settlement systems" (see para. 51), the Commission decided that, in subparagraph *(d)*, reference should also be made to inter-bank payment agreements. It was widely felt that, in addition to payment and securities settlement systems, payment arrangements between two correspondent banks should be excluded from the scope of the convention.

72. With respect to subparagraph *(f)*, the suggestion was made that it should be revised to refer also to the holding of investment securities. In response to a question, it was stated that the direct or indirect holding of investment securities, whether they were in paper or in electronic form ("dematerialized securities"), could generate receivables, such as the balance in a securities account, dividends from securities or the price from the sale of securities. It was generally agreed that the assignment of such receivables should be excluded from the draft convention, for the same reasons that the assignment of receivables arising from the sale or loan of investment securities was to be excluded (see para. 69).

73. The Commission also considered the definitions of "financial contract" and "netting agreement" that were referred to in subparagraph *(b)* of the above-mentioned list of exclusions (see para. 70) and should be included in article 6. The draft definitions (modelled closely on the text suggested by the European Banking Federation in document A/CN.9/472/Add.1) were as follows:

"*(n)* 'Financial contract' means any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, any deposit transaction and any other transaction similar to any transaction referred to above entered into in financial markets and any combination of the transactions mentioned above;

"*(o)* 'Netting agreement' means an agreement which provides for one or more of the following:

(i) The net settlement of payments due in the same currency on the same date whether by novation or otherwise;

(ii) Upon the insolvency or other default by a party, the termination of all outstanding transactions at their replacement or fair market values, conversion of such sums into a single currency and netting into a single payment by one party to the other; and

(iii)The set-off of amounts calculated as contemplated by the preceding subparagraph (ii) under two or more netting agreements."

74. It was noted that, in view of the Commission's earlier discussion of those definitions (see paras. 49-51), the reference to deposit accounts and to collateral and credit support systems in the definition of "financial contract" had been deleted. Wide support was expressed for those definitions as revised. It was agreed that deposit accounts were excluded by virtue of subparagraph *(c)* of the revised list of exclusions (see para. 70). A suggestion was made to remove receivables arising from deposit accounts from the lisv of excluded practices, but that suggestion did not receive sufficient support. The Commission also agreed that collateral and credit support systems did not fit into a definition of "financial contract". After discussion, the Commission adopted the above-mentioned list of exclusions and definitions and referred them to the drafting group.

Real estate receivables

75. The Commission resumed its deliberations on real estate receivables (see paras. 57-64). The discussion focused on a proposal that read as follows:

"Where a receivable is connected with an interest in land, the law of the State in which the land is situated governs all matters pertaining to that interest and the priority of the right of the assignee with respect to the competing right of a person who holds an interest in the land."

76. It was stated that the proposed text was intended to apply in all cases, irrespective of the connection of the receivable to land (e.g. whether the receivable arose from the sale or lease of land, or was simply secured by an interest in land), and to preserve the application of the law of the land on all matters relating to an interest in land. It was also observed that the second part of the proposed text was intended to address a more limited issue, namely, the issue of the law applicable to a conflict of priority between an assignee under the convention and the holder of an interest in land under the law of the land. Strong support was expressed for that proposal. It was stated that the proposed text would address the concerns expressed with regard to statutory limitations on assignments that could have an impact on interests in land, as well as any other public policy concerns in that regard. As a matter of drafting, it was suggested that the first and the second part of the proposed text should be connected with the word "including". That suggestion was objected to, since the second part of the proposed text contained a limited rule dealing with the law applicable to priority with respect to the receivable, while the first part dealt with the law applicable to all matters relating to an interest in land.

77. At the same time, a number of concerns were expressed. One was that the proposed text was overly broad and could inadvertently result in excluding from the scope of the convention transactions that were intended to be covered (e.g. an assignment of a receivable embodied in a promissory note and secured by a mortgage or the assignment of the income flow from an amusement park or a golf course). In particular, the words "connected" and "all matters pertaining" were considered to open up the scope of the proposed text too broadly and to be introducing an unacceptable degree of uncertainty. It was observed that

commercial loans were often secured by personal property and real property. In such situations, it was pointed out, priority with respect to the land-related receivable could be referred to the law of the land only if, under the law of the land, priority were to be subject to registration in a public registry and if a conflict with a holder of an interest in land were to arise. In that connection, it was stated that, if the assignee had not registered its interest in the land and the assignor were to become insolvent, the assignee's priority with respect to the insolvency administrator should be subject to the law of the assignor's location. It was also stated that, even if the assignor had assigned the same receivable to another assignee who had not registered either, priority should again be determined under the law of the assignor's location. Furthermore, it was observed that the only situation in which the law of the land could apply and the assignee could be defeated would be where a subsequent assignee had registered its interest under the law of the land. The second part of the proposed text was intended to cover that limited conflict situation.

78. Another concern was that the mere fact that a receivable had some connection to real estate, irrespective of the value of the real estate compared to the value of the receivable, was not sufficient to justify a change in the law governing priority. It was stated that, if the convention were to include a rule on the law governing conflicts of priority with respect to real estate receivables, that rule should be appropriately cast so as to avoid any undue interference with financing practices involving such receivables. Doubt was expressed as to whether the rule contained in the proposed text would be suitable for real estate financing and for financing on the basis of receivables secured by a mortgage. In any case, it was stated that a rule that would make it necessary for any receivables financier to investigate whether the relevant receivables were secured by a mortgage so as to establish whether the convention applied would be unacceptable. In order to address the concerns expressed, it was suggested that the convention should deal only with a conflict between an assignee who acquired, under article 12, an interest in the land securing payment of the assigned receivable and a holder of an interest in land, which by virtue of the law of the land extended to the receivable. Such a rule should preserve the application of the law of the land either by excluding that type of conflict from the scope of the priority rules of the convention or by giving priority to the holder of an interest in land, if that person would have priority under the law of the land.

79. The following language was proposed:

> "If a receivable is associated with the land such that under the law of the State in which the land is situated a person with an interest in the land has rights in that receivable, then the rights of the assignee with respect to the receivable are subordinate to the rights of any person to whom under the law of the State in which the land is situated the assignee's rights would be subordinate."

It was explained that the proposed rule was designed to have a narrow scope of application, since it required that a receivable be associated with land and that, under the law of the land, a person with an interest in land acquired an interest in the land-related receivable. It was explained that the proposed rule did not address conflicts with respect to interests in land, since article 12 was thought to be sufficient to ensure that any conflict with respect to interests in land would be resolved by the law of the land. It was also understood that the proposed rule would have no application if, as a result of debtor default, the assignee of a receivable secured by a mortgage were to foreclose and sell the land, as long as the assignee had met all the requirements existing under the law of the land for the acquisition of interests in land.

80. Some support was expressed for the proposal mentioned above. In order to ensure that the proposed text would cover not only rental payments but also receivables secured by real estate, the suggestion was made that it should be amended as follows: "Where a receivable is secured by land or arises from a lease of land …". At the same time, a number of concerns were expressed. One was that the proposed text failed to address all situations in which the convention might affect rights in land under the law of the land. In response to a question as to whether article 9 (in particular, as reformulated; see para. 131) would not cover any concern relating to statutory limitations relating to land-related receivables, it was observed that article 9 would address most but not all public policy concerns. In response to a further question as to whether article 25 would address those remaining public policy concerns, it was stated that the article might not be sufficient in that regard.

81. In order to bridge the gap between the two diverging proposals (see paras. 75 and 79), the following language was proposed: "No provision in this Convention shall affect the application of the law of the real estate when the assignment of a receivable is linked to that real estate". While the proposal was met with interest, it was stated that it might inadvertently result in creating uncertainty as to the application of the convention. The mere fact that, for example, a mortgage in real estate of a minor value was given could result in removing the assignment of receivables of considerable value from the scope of the convention. It was also pointed out that the only issue that needed to be covered was the conflict between an assignee under the convention and the holder of an interest in land linked to the receivable assigned. Statutory limitations with respect to the assignment of land-related receivables would be sufficiently covered by revised article 9 (see para. 131), while article 12 would be sufficient to ensure that any conflicts with respect to competing interests in land would be subject to the law governing interests in land by virtue of the rules of private international law outside the convention.

82. However, the concern was expressed that addressing only issues of priority would not be sufficient to preserve the application of the law of the land on all matters pertaining to an interest in land. For that reason, support was expressed for the proposal mentioned above (see para. 80) or for allowing States to exclude the assignment of land-related receivables from the scope of the draft convention (see articles 4, paragraph 2, and 39). It was widely felt that every effort should be made to define clearly the scope of the convention so that no further exclusions would need to be made by States, since such an approach would reduce certainty with respect to the application of the convention and result in its having a different scope from State to State.

83. In an effort to reach consensus, the following language was proposed:

"In the case of a receivable secured by or arising from the sale or lease of an interest in real estate, nothing in this Convention:

"*(a)* Affects the rights of a person entitled to priority in the receivable pursuant to the real estate law of the State in which the real estate is located; or

"*(b)* Authorizes an interest in the real estate that is not permitted under that law."

84. It was explained that the proposed text was intended to ensure that the convention would not affect the priority of a holder of an interest under the real estate law of the land and would not create an interest in land not permitted by the law of the land. While the proposal attracted support, with regard to subparagraph *(a)*, concern was expressed that the reference to the real estate law of the land was insufficiently clear and overly restrictive, since priorities were normally governed by other law, including insolvency law. In response, it was stated that referring to the law of the land in general would remove from the scope of the convention any conflicts of priority with respect to receivables linked to land, no matter how remote or artificial that link might be. Such a result would undermine the certainty sought through articles 24-27 and was said to be unacceptable, since it would fail to cover significant conflicts of priority with respect to receivables. The example was given of a conflict between two assignees in country A of a receivable secured by a mortgage in country B.

85. It was stated, however, that, as long as the convention made it clear that it was not intended to prejudice rights under real estate law, there would not be a need to address the specific issue of priority dealt with in subparagraph *(a)* of the proposed text. In response it was observed that, in the absence of subparagraph *(a)*, the law of the assignor's location would inadvertently apply by virtue of article 24 to a conflict between an assignee under the convention and a holder of a right in land that, under national law, was extended to the receivable.

86. As to subparagraph *(b)*, the suggestion was made that it should refer to "interference" with the law of the land. That suggestion was objected to, since the term "interference" might be excessively broad and was in any case unclear. As a matter of drafting, the suggestion was made that subparagraph *(b)* should refer to authorization with respect to the acquisition of a right in land, a suggestion that received wide support.

87. Subject to preserving the priority of interests in land arising from law governing interests in land, the Commission approved the text reflected in paragraph 83 and referred it to the drafting group. The Commission continued its discussion with respect to receivables arising from real estate transactions on the basis of a text to be added in article 4, which read as follows:

"[3.] This Convention does not:

"*(a)* Affect the question whether a property right in real estate is a right in a receivable related to that real estate;

"*(b)* Affect the priority of the right in real estate with respect to the right of an assignee of the receivable; or

"*(c)* Make lawful the acquisition of property rights in real estate not permitted under the law of the State where the real estate is situated."

The concern was expressed that subparagraph *(a)* departed from the policy approved by the Commission (see paras. 83-87) and was incomprehensible, since an interest in real estate could not be an interest in a related receivable. In response, it was stated that subparagraph *(a)* was a logical prerequisite for a conflict of priority as described in subparagraph *(b)* to arise. As to whether the holder of an interest in land could have an interest in land-related receivables and thus find itself in a conflict of priority with an assignee of those receivables, by way of an example, it was stated that in many jurisdictions the buyer of a building acquired an interest in rents from the lease of the building. As a matter of drafting, it was suggested that the word "confers", "contains" or "includes" should be substituted for the word "is" in subparagraph *(a)*. After discussion, the Commission approved the proposed text and referred it to the drafting group.

Further practices to be excluded (assignments of receivables from sales or leases of aircraft, space equipment and railway rolling stock)

88. The suggestion was made that, for the same reasons mentioned above (i.e. highly regulated, special markets that did not need to be covered by the convention), the assignment of receivables arising from leases of or secured by certain types of high-value mobile equipment should be excluded from the convention. In favour of that proposal, it was stated that an outright exclusion of such practices would avoid introducing rules that might not be appropriate (e.g. articles 11, 12 or 24). It was also observed that such an approach would result in avoiding creating conflicts with a draft convention currently being prepared by the International Institute for the Unification of Private Law (Unidroit) ("the draft Unidroit convention") and other organizations. In that connection, it was explained that further to the decision of the relevant bodies preparing those texts to limit the scope of their work to aircraft, space equipment and railway rolling stock (instead of to any "uniquely identifiable object"), an outright exclusion would be a limited one and would not risk excessively limiting the scope of the draft convention being prepared by UNCITRAL. Furthermore, it was explained that the draft Unidroit convention and the protocols thereto dealt in an industry-specific way with remedies upon default of the debtor and introduced a priority regime based on international, equipment-specific registries.

89. In order to implement that proposal, language along the following lines was suggested for inclusion in the list of excluded practices in draft article 4, paragraph 1: "The assignment of rights [to payment] arising from transactions in which mobile equipment is leased or is the primary real security for obligations incurred". That language would be supplemented by the following definition: "'Mobile equipment' means airframes, aircraft engines, helicopters, railway rolling stock and space property." In response to a

question, it was stated that, while there was not yet a definition of the term "space property", that term was used to reflect not only equipment in outer space (e.g. satellites), but also any associated rights (e.g. any telemetry, tracking and command facility; satellite command and control software, as well as access codes; and governmental authorizations for use of the assigned orbital location and associated radio frequencies). It was observed that, as a practical matter, the right of a secured creditor to take possession of a satellite could not be assured without the associated rights. As a result, exclusion of associated rights from a security interest in the relevant satellite itself would erode the commercial value of the satellite as collateral and thus undermine the ability of satellite manufacturers, launch service providers and satellite operators to obtain financing offering non-possessory security interests in their satellites. It was also stated that it was important for the draft convention to avoid any interference with the draft space protocol being prepared, since that draft protocol would be the first international text dealing in a comprehensive way with security interests in space equipment (although other international texts, such as the Unidroit Convention on International Leasing (1988), could be considered applicable to the lease of space equipment).

90. Strong support was expressed initially for the proposed exclusion. It was stated that those categories of mobile equipment were of a kind traditionally regarded as enjoying special status, which was recognized in the proposed new international regime provided in the draft Unidroit convention and protocols. In addition, it was pointed out that the highly specialized nature of financing techniques of such mobile equipment required that assignments of receivables taken as security be dealt with in equipment-specific instruments. Moreover, it was said that the proposed exclusion was needed in order to preserve the concept of indivisibility of the asset and the associated rights, a concept enshrined in articles 8, paragraph 1, and 10 of the draft Unidroit convention. That concept could be undermined if the debtor could assign receivables derived from such high-value mobile equipment under a system different from that applicable to that mobile equipment. In order to avoid such a result, the assignment of receivables arising from the following transactions, in particular, should be excluded from the scope of the convention: the financing of sales by sellers retaining title until full payment of the price; the financing of sales by third-party financiers obtaining a security right in the relevant mobile equipment; the financing of leases in which rental payments were fused with the mobile equipment; and the financing of companies owning mobile equipment by financiers obtaining a security right through loans primarily secured by the mobile equipment.

91. The view was expressed that a conflict between two texts that had not yet been finalized could not be addressed by means of an outright exclusion of certain practices. Such an approach would result in a legal vacuum until the more specialized text had been finalized and had entered into force. It was therefore suggested that the matter should be left to article 36 and to the draft Unidroit convention and protocols that could supersede the draft convention being prepared by UNICITRAL. In response, it was pointed out that the main issue was not one of conflicts between two international texts, but the need to avoid interference with a well-functioning and highly specialized practice. The issue of conflicts between international texts was a secondary one and related not only to a future international text but also to currently existing international conventions. In any case, an approach based on article 36 or on general treaty law would fail to provide the certainty necessary for credit to be made available at affordable rates. In that connection, it was explained that, in order to determine which text applied, parties would need to establish the location of the relevant parties in a State having made a declaration, as well as the effect of such a declaration.

92. The view was also expressed that an outright exclusion would be inappropriate, since the draft convention appropriately dealt with financing on the basis of receivables in a broad way and had a different objective from the draft Unidroit convention and protocols on international interests in mobile equipment. In addition, it was observed that the proposed language might be excessively broad in that it would inadvertently result in excluding an assignment of a receivable from the scope of the convention, even if the owner of the mobile equipment had paid the price secured by the security in the mobile equipment. It was considered that such a result would be inappropriate. It was, therefore, suggested that it would be better to leave the matter to parties to choose by opting into the draft convention being prepared by UNCITRAL or the draft Unidroit convention and protocols on international interests in mobile equipment. In response, it was stated that rights associated with security interests in high-value mobile equipment were, in some important practices, inextricably linked with that equipment and those transactions could not be subject to a different law on assignment of receivables. It was also stated that leaving the matter to parties would create uncertainty as to the application of both conventions.

93. The concern was expressed that the proposed language left open the question whether the assignment of receivables in transactions in which the types of equipment to be excluded were not the primary security would be covered by the draft UNCITRAL convention or by the draft Unidroit convention and protocols on international interests in mobile equipment. It was stated that, in such situations, a conflict could arise between the relevant texts and the problem should be addressed in the draft UNCITRAL convention. In response, it was stated that in situations in which the security in the types of mobile equipment proposed to be excluded would be only a secondary security the assignment of receivables would not be excluded from the scope of the convention.

94. The concern was also expressed that, unless the scope of the exclusion was carefully delimited, a general financier might be able to change the regime applicable to assignments by including in a receivables financing transaction an aircraft receivable. In addition, it was stated that an exclusion of assignments of receivables from railway rolling stock and space equipment was not possible at the current stage, especially as the scope of the relevant draft protocols was still unclear and in any case they had yet to be considered and approved in an intergovernmental context. It was also observed that chapter IX of the draft Unidroit convention (dealing with assignments of interna-

tional interests and "associated rights", including receivables) had not been finally adopted and that alternative provisions had been annexed to that chapter on the understanding that that matter would be re-examined by a small expert group before the diplomatic conference planned so as to conclude the draft convention. Furthermore, it was pointed out that an approach based on an exclusion would inadvertently result in an exclusion of a wide range of practices from the scope of the convention, whether or not a country was a party to the draft Unidroit convention or had legislation dealing with such matters. Moreover, even an approach based on article 36 would need to be deferred until the draft UNIDROIT convention and protocols had been finalized. Furthermore, including the assignment of aircraft and similar receivables within the ambit of the UNCITRAL convention would not risk disrupting any markets. In that connection, the attention of the Commission was drawn to the fact that recent studies had shown that the exclusions sought would create special regimes where none currently existed and might unduly affect significant practices, such as those involving the securitization of aircraft receivables.

95. In response, it was pointed out that, while the Commission might benefit from further consultations on the matter, it was clearly essential to resolve it in a reasonable way and to the satisfaction of the relevant industry so as to avoid raising opposition to the draft convention. It was also stated that an approach based on a limited exclusion of receivables that were inextricably linked with a high-value type of equipment and a priority rule referring to the State of registration might work well, at least for aircraft financing practices. In addition, a solution based on article 36, dealing with conflicts with other international texts, could not fully address the problems under discussion. In opposition to that view, it was observed that article 36 would be sufficient to settle the matter. In addition, the fact that receivables were inextricably linked with the equipment did not justify an exclusionary approach. The key issue was that under the draft Unidroit convention and protocols an equipment financier would always have priority over a receivables financier.

96. Noting the strong views expressed both in favour of and against an exclusion of assignments of receivables arising from transactions relating to high-value, highly mobile assets, the Commission decided to defer a decision on the matter until the draft Unidroit convention was closer to completion, which would allow Governments to undertake the necessary consultations with the relevant industries.

Placement of the list of receivables to be excluded

97. The Commission considered the question whether the receivables in the list were to be excluded from the draft convention in toto or whether the identified receivables should receive special treatment only in certain provisions. Some support was expressed for a selective approach, according to which each receivable would be excluded (or dealt with in a special way) only to the extent necessary to avoid problems in a particular area, while preserving the applicability of other provisions of the draft convention. That approach was said to be in line with the desire to obtain as broad as possible a scope of application of the convention and to facilitate, to the extent possible, assignment-related financing operations. Nevertheless, the widely prevailing view was that it was preferable to exclude the identified receivables completely from the sphere of application of the convention. That view was a result of the assessment according to which tailor-made exclusions would cause difficulties of interpretation and would complicate the application of the convention. It was stated, in particular, that variant B of article 5 would have to be expanded and tailored so as to adapt the convention to the needs of particular types of practices. Such adjustments, it was observed, might be necessary as regards, for example, priority issues, rights of set-off, representations and the meaning of the term "location". Furthermore, total exclusions would reduce the need for (or make superfluous) articles 4, paragraph 2, and 39, which by allowing States to exclude further practices might create complications in the application of the Convention.

98. After having suspended consideration of the matter to allow some time for consultation among delegates, the Commission continued its discussion, focusing on the question whether the list of practices to be excluded from the scope of the convention should be placed in article 5 and incorporated into variant B or articles 11 and 12. Some support was expressed in favour of placing the list in article 5, variant B. It was stated that excluding the practices mentioned in that list only from the scope of articles 11 and 12 would be in line with the overall policy, approved by the Commission, that the scope of the convention should be as broad as possible. It was also observed that such an approach would enhance predictability with regard to the application of the convention. At the same time, it was recognized that the definition of "trade receivable" in variant B of article 5 introduced an unacceptable degree of uncertainty and should therefore be deleted, while direct reference to specific practices should be made. The following language was proposed for inclusion in draft article 5:

> "Articles 11 and 12 [and section II of chapter V] do not apply to assignments of receivables [list of practices to be excluded]. With respect to the assignment of such receivables, the matters addressed by these articles are to be settled in conformity with the law applicable by virtue of the rules of private international law."

99. The prevailing view, however, was that the list of practices to be excluded should be placed in article 4. It was stated that, if those practices were to be excluded only from the scope of articles 11 and 12, the convention might still apply, depending on whether the law applicable outside the convention would give effect to anti-assignment clauses. In such a case, it was stated, the Commission would need to adjust a number of provisions of the draft convention (e.g. the rules on "location", representations, debtor's rights of set-off and priority issues) to the particular needs of the practices proposed to be excluded. In the discussion, the suggestion was made that in subparagraph *(d)* of the proposed list of exclusions (see para. 70), language might need to be added to ensure that inter-bank payment systems and securities settlement systems were excluded "whether or not they are governed by netting agreements". It was also suggested that subparagraph *(f)* should indicate clearly that it included repurchase agreements.

100. After discussion, the Commission decided that the list of practices to be excluded should be appropriately incorporated into article 4 and referred the matter to the drafting group (as to whether articles 5 and 6, paragraph 1, should be retained, see paras. 104-108 and 151).

Specific list of receivables to be included

101. The Commission subsequently turned to a discussion of the advisability of including in the draft convention a list of receivables, the assignment of which would be covered by the convention. In support of such a list, it was stated that it would provide immediate and express assurance and clarification to the interested industries benefiting most from the convention that those practices were covered by it. Those practices included, in particular, the supply of goods, works and services, the sale or licence of intellectual property, credit card transactions, as well as the lending of money and payments on guarantees or surety obligations. Such an approach was said to be a practical one that would foster the acceptability of the convention and facilitate its interpretation. However, there was considerable opposition to including such a list of practices. The opinion was expressed that such a list would unnecessarily limit the scope of application of the convention and thus run counter to the generally approved policy for the convention to have as broad a field of application as possible. In addition, a juxtaposition of a list of exclusions and a list of inclusions might cause difficulties of interpretation with respect to practices for which it was not entirely clear where they belonged or practices that might develop in the future. Moreover, it was observed that the list would be superfluous, since it would be merely restating, by using the most typical examples, the transactions that were covered by the convention by virtue of article 2. Furthermore, it was stated that if the list of practices to be excluded were to be added in article 4, paragraph 1, article 5 would not be necessary and, as a result, a distinction between financial and trade receivables would be superfluous and could inadvertently result in excluding trade receivables.

102. The Commission adopted the view that the convention should not set out a list of transactions to be included in the scope of the convention, but that a clarification to that effect should be made in a commentary or in the preamble to the convention.

103. After having suspended consideration of the matter to allow time for consultation among delegates, the Commission resumed its deliberations on the list of practices proposed to be included in the scope of the convention. While the view was expressed that such a list might usefully further clarify the scope of application of the convention, it was widely felt that such a list was not necessary. It was stated that article 2, which defined "assignment" and "receivable" in sufficiently broad terms, was sufficient to cover all the practices included in the list. It was also observed that a list of practices to be included might inadvertently limit the scope of application of the convention even further than intended. In the discussion, it was suggested that the list of practices to be included might be usefully mentioned in a commentary or in the preamble to the convention. After discussion, the Commission decided that no reference should be made to such a specific list of practices for the purposes of defining the scope of application of the convention.

Practices to be excluded from the scope of articles 11 and 12

104. The Commission next considered the related question whether certain practices should be excluded from the scope of articles 11 and 12 (see para. 38). It was proposed that variant B of article 5 be retained and supplemented by a definition of "trade receivable", which would read as follows:

"'Trade receivable' means a receivable:

"(i) Arising under an original contract for the sale or lease of goods or the provision of services other than financial services;

"(ii) Arising under an original contract from the sale, lease or licence of industrial or other intellectual property or other information;

"(iii) Representing the payment obligation for a credit card transaction."

105. In support of that proposal, it was stated that there were other practices beyond those to be excluded in article 4 for which articles 11 and 12 would not be suitable. The example was given of loan syndication, as well as factoring and invoice discounting agreements, in which anti-assignment clauses were normally given effect. It was observed that, if those practices were excluded from the scope of articles 11 and 12, by virtue of the second part of article 8, paragraph 2, the effectiveness and the legal consequences of anti-assignment clauses would be left to law applicable outside the convention. As a result, if the applicable law were to give effect to an anti-assignment clause, an assignment would not be effective and the convention would not come into play. If, on the other hand, the applicable law gave no effect to the anti-assignment clause, the assignment would be effective and the convention would apply. For that reason, the preservation of the application of the debtor protection provisions, contained in section II of chapter IV (through a deletion of their exclusion in article 5, variant B), was considered most important. In response to a question, it was clarified that those provisions of the convention could apply to practices to be excluded from the scope of articles 11 and 12 without risking disrupting those practices.

106. At the same time, the proposal raised a number of concerns. One concern was that the distinction between trade and financial receivables would create uncertainty. It was stated that the reference to financial services in the above-mentioned definition (see para. 104) left open whether it included only services by banks or also by other finance service providers. A suggestion to refer only to banks was objected to on the ground that such an approach would fail to address practices involving, for example, insurance companies. Another concern was that the proposed exclusion might inadvertently result in excluding the assignment of a trade receivable merely because, subsequent

to the original assignment by a trader to a bank, it was assigned by that bank to another bank. In response, it was stated that, once a receivable was a trade receivable, it would always be a trade receivable (and, as a result, its subsequent assignment by a bank would not be excluded by the proposed text). Yet another concern was that the distinction could lead to inconsistent results (e.g. an assignment of trade receivables backed by a letter of credit would not be covered, while an assignment of receivables without any credit guarantee would fall within the ambit of the convention).

107. In order to address those concerns, the suggestion was made that the scope of articles 11 and 12 could be limited by way of a specific list of exclusions without any reference to a definition of "trade receivable". The above-mentioned proposal (see para. 104) was amended to read: "Draft articles 11 and 12 apply only to assignments of receivables [list (i)-(iii) from para. 6]." A query was raised as to the meaning of the term "financial services" and in particular as to whether the term would include services offered by an institution other than a financial institution. The Commission decided to postpone consideration of the proposal until it became available in versions in all six official languages of the United Nations (for the continuation of the discussion, see paras. 145-151).

108. During the discussion, it was suggested that receivables arising from bank deposits should be excluded from the scope of articles 11 and 12, but not from the scope of the convention as a whole. While some support was expressed for that suggestion, it was widely felt that it could not be adopted, since, in particular, the definition of the term "location" would not be appropriate for banks. It was stated that, if the anti-assignment clause were not given effect by the law applicable, the assignment could be effective, the convention could apply and, as a result, priority issues with respect to a conflict with a branch of a bank would be referred to the law of the State in which the head office of that bank was located, a result that was said to be inappropriate. For that reason, the Commission decided to retain the assignment of receivables arising under deposit accounts in the list of practices to be excluded from the scope of the convention as a whole (see para. 70).

Further exclusions by States through declarations (articles, 4, paragraph 2, and 39)

109. It was noted that articles 4, paragraph 2, and 39 were intended to enhance the acceptability of the draft convention to States by allowing them to exclude further practices from the scope of the convention as a whole. It was widely felt, however, that those provisions should be deleted. It was stated that an approach along the lines of articles 4, paragraph 2, and 39 would result in uncertainty, since the scope of the convention might become difficult to determine and, in any case, might end up being different from State to State. Pending final determination of the scope of articles 11 and 12, the Commission decided to defer a final decision on articles 4, paragraph 2, and 39 to a later stage (for the continuation of the discussion, see para. 152; see also para. 32).

CHAPTER II. GENERAL PROVISIONS

Article 6. Definitions and rules of interpretation

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

"For the purposes of this Convention:

"*(a)* 'Original contract' means the contract between the assignor and the debtor from which the assigned receivable arises;

"*(b)* 'Existing receivable' means a receivable that arises upon or before the conclusion of the contract of assignment; 'future receivable' means a receivable that arises after the conclusion of the contract of assignment;

"[*(c)* '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, forfeiting, securitization, project financing and refinancing;]

"*(d)* 'Writing' means any form of information that is accessible so as to be usable for subsequent reference. Where this Convention requires a writing to be signed, that requirement is met if, by generally accepted means or a procedure agreed to by the person whose signature is required, the writing identifies that person and indicates that person's approval of the information contained in the writing;

"*(e)* 'Notification of the assignment' means a communication in writing which reasonably identifies the assigned receivables and the assignee;

"*(f)* 'Insolvency administrator' means a person or body, including one appointed on an interim basis, authorized in an insolvency proceeding to administer the reorganization or liquidation of the assignor's assets or affairs;

"*(g)* '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 or other competent authority for the purpose of reorganization or liquidation;

"*(h)* 'Priority' means the right of a party in preference to another party;

"*(i)* A person is located in the State in which it has its place of business. If the assignor or the assignee has more than one place of business, the place of business is that place where its central administration is exercised. If the debtor has more than one place of business, the place of business is that which has the closest relationship to the original contract. If a person does not have a place of business, reference is to be made to the habitual residence of that person;

"*(j)* 'Law' means the law in force in a State other than its rules of private international law;

"*(k)* 'Proceeds' means whatever is received in respect of an assigned receivable, whether in total or partial payment or other satisfaction of the receivable. The term includes whatever is received in respect of proceeds. The term does not include returned goods;

"[*(l)* 'Trade receivable' means a receivable arising under an original contract for the sale or lease of goods or the provision of services other than financial services.]"

111. The Commission decided to postpone the discussion of subparagraphs *(c)*, *(h)* and *(j)* until it had had a chance to consider the title and the preamble, the priority rules and the federal state issues in the final provisions (for the discussion of subparagraph l, see paras. 104-107 and 145-151; with regard to subparagraph *(c)*, see para. 184).

112. Discussion focused on subparagraph *(i)* (definition of "location"). It was generally agreed that the subparagraph was one of the most important provisions of the convention, since it was relevant for the determination of the scope of application and the priority rules of the convention. Differing views were expressed.

113. One view was that subparagraph *(i)* was in principle an appropriate rule that would work well in the majority of cases. According to that view, the subparagraph would not work as well for those industries which operated with branch offices (in particular, the banking and insurance industry). In support of that view, it was observed that it would not be appropriate to refer priority issues with respect to transactions of a company made through a branch office in one country to the law of another country where that company happened to have its central administration. In addition, it was stated that failing to address that matter might result in reducing the acceptability of the convention. In order to address those special cases in which a place-of-central-administration rule might not work, a number of suggestions were made. One suggestion was to refer to the location of the branch in whose books the receivables appeared immediately before the assignment (see A/CN.9/466, paras. 98 and 99). That suggestion was objected to on the grounds that such an approach would not enhance certainty and transparency, since third parties would not know in whose books the receivables appeared and, in any case, books (in a paper or electronic form) could be kept in a jurisdiction that was irrelevant to the assignment contract. Another suggestion was that the exception could be formulated along the lines of article 1, paragraph 3, of the UNCITRAL Model Law on International Credit Transfers ("branches and separate offices of a bank in different States are separate banks"). That suggestion was objected to on the grounds that such an approach would not resolve the problems arising in the case of a conflict between an assignment of the same receivables by two different branch offices of the same bank, while it would be very difficult to reach agreement on a uniform definition of the term "bank". Those objections were cited against another suggestion made to refer to the branch of a banking or insurance company with which the assignment had the closest relationship.

114. Another view was that the location of branch offices needed to be addressed in a consistent manner for all industries that operated throughout the world through branch offices rather than through independent subsidiaries. Accordingly, instead of introducing a narrow exception for banks and insurance companies, a different location rule should be introduced that would deal with the location of the assignor, the assignee and the debtor on the basis of the place of business with the closest relationship with the relevant contract. Various suggestions were made, including a suggestion that subparagraph *(i)* should read:

"If the assignor or the debtor has more than one place of business, the relevant place of business is the one which has the closest relationship to the original contract. If the application of this rule designates more than one place of business of the assignor or the assignee [, located in different States], the relevant place of business is that where its central administration is exercised."

Support was expressed for that suggestion, in particular in view of the fact that it would solve the problem of determining the location of the assignor in the case of multiple assignments by branch offices of the same entity.

115. However, the suggestion was objected to on the grounds that reference to a closest-connection test would significantly reduce the certainty aimed to be achieved through the convention and would have a negative impact on the cost and the availability of credit. It was pointed out that, in the case of future receivables, the place with the closest connection to the original contract could not be determined at the time of assignment and, in the case of bulk assignments, there might be various places with closest connection to the original contracts as there were several original contracts. It was also observed that, in many practices, the considerations applicable to the determination of the location of the assignor (borrower) and the assignee would normally differ from the relevant considerations in the determination of the location of the debtor. It was also stated that the suggestion failed to take into account the need to link the location of the assignor with the assignment contract, which in that context was more important than the original contract. In view of the wide divergence of views, the suggestion was made that a place-of-business approach should be followed to define the location for the application of the convention and a central-administration rule should be adopted for the purposes of the priority provisions of the convention. That suggestion was objected to as it would fail to enhance certainty with regard to the application of the convention and would lead to inconsistent results, without resolving the problems arising with regard to branch offices.

116. During the discussion, a number of additional suggestions were made with regard to other issues. One suggestion was that, in cases where the location of the debtor could not be determined, reference should be made to the place of the central administration or the place from which payment emanated. There was insufficient support in the Commission for that suggestion. Another suggestion was that subparagraph *(i)* should be revised to deal with multiple places of business only if they were located in different countries. While it was noted that that matter was already implicit in subparagraph *(i)*, it was agreed that it could usefully be clarified further. Another suggestion was that, for the sake of clarity, reference should be made to the "ordinary" rather than to the "habitual" residence of the debtor. There was no support for that suggestion.

117. Subject to the reference to more than one place of business in different countries, the Commission approved the substance of subparagraph *(i)* and referred it to the drafting group.

118. With regard to subparagraph *(k)*, concern was expressed that, by excluding from the definition of "proceeds" goods returned by the buyer to the seller (e.g. because they were defective, because the sales contract was cancelled or because the buyer did not wish to retain them after the expiry of a trial period), it could inadvertently undermine certain practices. It was explained that in such practices the assignee, having paid the assignor/seller, acquired a property right in any goods returned by the buyer to the assignor/seller. The suggestion was made that the last sentence of subparagraph *(k)* should be deleted, since in any event, under subparagraph *(k)*, "proceeds" would not encompass "returned goods". The Commission noted that the issue of "returned goods" arose in the context of articles 16 and 24 and deferred consideration of the matter until it had discussed those articles (see para. 167).

Article 7. Party autonomy

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

> "The assignor, the assignee and the debtor may derogate from or vary by agreement provisions of this Convention relating to their respective rights and obligations. Such an agreement does not affect the rights of any person who is not a party to the agreement."

120. The Commission noted that the draft article was modelled on article 6 of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980; "the United Nations Sales Convention"). It was also noted, however, that, unlike article 6 of the United Nations Sales Convention, article 7 of the draft UNCITRAL convention did not allow parties to vary or derogate from provisions that affected the legal position of third parties or to exclude the Convention as a whole. The reason for that different approach was said to be that, while the United Nations Sales Convention dealt with the mutual rights and obligations of the seller and the buyer, the draft UNCITRAL convention dealt mainly with the proprietary effects of assignment and could, therefore, have an impact on the legal position of the debtor and other third parties. The Commission proceeded to consider article 7 on the understanding that agreements between the assignee and the debtor would not be covered by the convention (see A/CN.9/470, para. 150). A suggestion to revise article 7 so as to allow the parties to exclude the application of the convention altogether did not receive support. In the discussion, some doubt was expressed as to whether a choice by the parties of the law of a non-contracting State would always result in excluding the application of the convention.

121. The Commission decided that language should be added to the article to clarify that it did not empower the parties to derogate from the provisions of article 21, which limited the scope of waivers of defences that might be agreed by the debtor and the assignor. It was stated that a similar reference might need to be made to other provisions of the draft convention so as to ensure that consumer-protection legislation would not be interfered with (as regards consumer protection, see paras. 170-172). Deferring a final decision on the matter to a later stage and subject to inclusion of a reference to article 21 in article 7, the Commission approved the substance of article 7 and referred it to the drafting group.

Article 8. Principles of interpretation

122. The text of draft article 8 as considered by the Commission 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."

123. It was proposed that paragraph 1 expressly mention the preamble to the convention among the elements that should be taken into account in the interpretation of the convention. The formulation "[regard is to be had] to its object and purpose as set forth in the preamble" was proposed (see article 4, paragraph 1, of the Unidroit Convention on International Factoring, Ottawa, 1988; "the Ottawa Convention"). Subject to that change, the Commission approved the substance of paragraph 1 and referred it to the drafting group.

124. With regard to paragraph 2, the suggestion was made that it might need to be revised to ensure that the law applicable by virtue of the private international law rules of the convention was to be applied first and then, only as necessary, the law applicable by virtue of the rules of private international law of the forum. It was also generally considered that the possibility of applying general principles or the law applicable by virtue of the rules of private international law extended only to the substantive law part of the convention and not to chapter V. Noting that the interplay between article 7 and chapter V would depend on the scope and purpose of chapter V, a matter that would need to be considered by the Commission, the Commission postponed a decision on the matter until it had finalized chapter V.

CHAPTER III. EFFECTS OF ASSIGNMENT

Form of assignment

125. The Commission noted that the draft convention did not settle the issue of the form of assignment. It was noted that failure to address the matter could create difficulties or uncertainty as to the validity of an assignment. An assignee under the convention would need to establish the formal validity of an assignment under law outside the convention (without having a clear indication as to which law might apply), the material validity of an assignment partly under

the convention and partly under other law outside the convention and priority under the law of the assignor's location. Such a result could have a negative impact on the cost of credit. It was also noted that failing to address the issue of form in the convention would raise uncertainty as to whether the convention intended the matter to be referred to law applicable outside the convention or to be settled in favour of the principle that no form was required (favor cessionis), a result that was said to be inconsistent with the policy underlying the decision of the Working Group not to address the issue of form. Furthermore, it was noted that identifying the law applicable to the form of assignment might be difficult. In that connection, the example was given of article 9 of the Convention on the Law Applicable to Contractual Obligations (Rome, 1980), where it was not clear whether it provided a solution also for the form of assignment as a transfer (at least for those jurisdictions where a clear distinction was drawn between the contract to assign and the assignment itself).

126. Some support was expressed for the position that no provision on form requirement should be included in the draft convention. It was stated that a number of issues regarding the contract of assignment had been left out of the draft convention and that, in view of the difficulties in finding an agreed solution on form requirements, it was preferable not to deal with the issue at all. It was also observed that, to the extent that it was not clear that the form of assignment was outside the scope of the convention, the matter should be clarified in a commentary.

127. The prevailing view, however, was that, in order to avoid difficulties (noted above in para. 125), it was advisable to resolve the issue of form (of the contract of the assignment and the assignment itself). It was considered that it would not be possible to reach consensus on a uniform form requirement or on a uniform private international law rule that would determine the law governing form requirements. However, there was broad support for providing a "safe-harbour" type of rule that would give the parties the certainty that, if they complied with the form requirement of the law of the assignor's location, the assignment would not be invalidated for failing to meet the form requirements of the law that would otherwise apply. Such a safe-harbour rule would refer form to a single and easily identifiable jurisdiction without necessarily restricting the parties to the form requirements of one law, but would leave them the choice of following the form requirements of either the law that (according to the rules of private international law) governed form or of the law specified in the convention.

128. A suggestion was made to define what was meant by "form". According to one view, the concept should be understood broadly and should cover not only the narrow issue of whether the assignment should be recorded in a written or electronic form, but also issues such as whether the assignment should be registered and whether and how the debtor should be notified of the assignment. The prevailing view, however, was that the draft convention should not attempt to define the requirements that fell within the notion of form and that, in any case, for a safe-harbour rule it was not necessary to define in a uniform manner the notion of form.

129. The Commission considered several proposals for the formulation of a safe-harbour rule. One proposal read as follows: "An assignment shall be considered formally valid if it meets, at least, the formal requirements of the law of the State in which the assignor is located" (see A/CN.9/470, para. 82). That proposal did not attract sufficient support, since it could be misunderstood as providing a uniform rule on the form requirement. Another proposal read: "Without prejudice to the formal validity of the assignment on the grounds of any other applicable law, an assignment is [effective] [formally valid] if it meets the form requirement of the law of the State in which the assignor is located." There was no support for that proposal either, since the requirements referred to might be applicable "subject to" (i.e. cumulatively with) the form requirements of the law applicable by virtue of the rules of private international law. Having reiterated its intention to provide a safe-harbour rule (which should pursue the principle in favorem negotii to the extent possible), the Commission decided that a safe-harbour rule should be included in the draft convention, referring form either to the law applicable by virtue of the rules of private international law or to the law of the assignor's location. The precise formulation of that rule was referred to the drafting group.

Article 9. Effectiveness of bulk assignments, assignments of future receivables and partial assignments

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

"1. An assignment of existing or future, one or more, receivables and parts of, or undivided interests in, receivables is effective, whether the receivables are described:

"*(a)* Individually as receivables to which the assignment relates; or

"*(b)* In any other manner, provided that they can, at the time of the assignment, or, in the case of future receivables, at the time of the conclusion of the original contract, be identified as receivables to which the assignment relates.

"2. Unless otherwise agreed, an assignment of one or more future receivables is effective at the time of the conclusion of the original contract without a new act of transfer being required to assign each receivable."

Paragraph 1

131. It was noted that article 9 was not intended to override statutory limitations other than those referred to in paragraph 1. The Commission agreed that that understanding needed to be reflected explicitly in article 9. The following language was proposed: "This Convention does not affect any statutory limitations on assignment other than those referred to in article 9" (see A/CN.9/470, para. 85). It was stated that the proposed language should be expanded to cover statutory limitations giving effect to contractual limitations on assignment of receivables and of rights securing receivables. The following text was proposed:

"This article is subject to any applicable statute, other than a statute of the type described in paragraph 4 [*of the text proposed in A/CN.9/472/Add.3, p. 12*], that prohibits or limits the assignment of a receivable for a reason other than the existence of a contractual prohibition or limitation of such assignment."

132. It was also noted that article 9 dealt with the effectiveness of an assignment as between the assignor and the assignee and as against the debtor, while the effectiveness as against third parties other than the debtor (i.e. priority) was governed by the law applicable under article 24. It was agreed that article 9 should be appropriately amended to reflect that distinction between effectiveness and priority, in particular for the sake of clarity in the application of the convention in those jurisdictions in which such a distinction was not known. It was also agreed that article 9 should make it clear that it was not intended to supplant the rules of priority of the law applicable or to allow prohibitions on bulk assignments or on assignments of future receivables to come through the back door through the use of a priority rule applicable under articles 24-27. In order to reflect that agreement, it was proposed that the wording of paragraph 1 make it clear that it applied to effectiveness as between the assignor and the assignee and as against the debtor. Similarly, the proposal was made that a new paragraph be inserted in article 9 to read: "A transfer of a receivable is effective, as between the assignor and the assignee, at the time of transfer" (see A/CN.9/472/Add.3, p. 12). It was agreed that the wording should make it clear that the assignment was effective as against the debtor as well.

133. In addition, it was proposed (see A/CN.9/470, para. 88) that a new paragraph be added to article 9 to read:

"The effectiveness of an assignment of receivables referred to in paragraphs 1 and 2 of this article as against third parties other than the debtor is governed by the law applicable under article 24. However, such an assignment is not ineffective as against such third parties on the sole ground that the law of the assignor's location does not recognize its effectiveness."

While there was general agreement on the principle embodied in the proposed text, it was stated that the first sentence might not be necessary since it repeated the rule reflected in article 24, while the second sentence might go too far in that it might affect rules of insolvency law as to the effectiveness of an assignment of receivables arising after the commencement of an insolvency proceeding with respect to the assets and the affairs of the assignor. In order to address that matter as well, the following text was proposed:

"A transfer of a receivable is not ineffective against, and may not be subordinated to, a person described in subparagraph *(a)* of article 24, solely because law other than this Convention does not *generally* recognize an assignment described in paragraph 1 or 2."

It was also proposed (see A/CN.9/472/Add.3, p. 12) that one more additional paragraph be added to article 9 to read: "*Except as otherwise provided in this article*, whether a transfer of a receivable affects the rights of a person described in subparagraph *(a)* of article 24 is determined in accordance with section III of chapter IV."

134. Subject to the changes mentioned in the preceding paragraphs, the exact formulation of which was referred to the drafting group, the Commission approved the substance of paragraph 1.

Paragraph 2

135. It was noted that, as a result of the substitution of the words "at the time of the conclusion of the original contract" for the word "arises", made by the Working Group at its thirty-first session, paragraph 2 appeared to address the issue of the time of assignment in a way that was inconsistent with article 10. It was noted that paragraph 2 was not intended to deal with that matter but only with the validity of master agreements covering a multiplicity of present and future receivables. It was therefore agreed that the words "at the time of the conclusion of the original contract" should be deleted. Subject to that change, the Commission approved the substance of paragraph 2 and referred it to the drafting group.

Article 10. Time of assignment

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

"An existing receivable is transferred, and a future receivable is deemed to be transferred, at the time of the conclusion of the contract of assignment, unless the assignor and the assignee have specified a later time."

137. The concern was expressed that articles 9 and 10 could be read as overriding the domestic insolvency law of the assignor's jurisdiction regarding priorities with respect to receivables arising after the commencement of the insolvency proceeding or earned after the commencement of the insolvency proceeding by the use of unencumbered assets of the insolvency estate. Such an interpretation could arise from the fact that article 24 explicitly stated that it did not cover "matters which are settled elsewhere in this Convention" and article 10 contained no explicit wording as to whether it was intended to affect the rights of third parties.

138. There was general agreement that the question of the extent to which an assigned receivable arising or being earned after the commencement of the insolvency proceeding should be subject to the applicable insolvency law (on this matter, see also para. 133). Subject to that change, the exact formulation of which was referred to the drafting group, the Commission approved the substance of article 10.

Article 11. Contractual limitations on assignment

139. The text of draft article 11 as discussed by the Commission was as follows:

"1. An assignment of a receivable is effective notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee 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 for breach of such an agreement. A person who is not party to such an agreement is not liable on the sole ground that it had knowledge of the agreement."

General policy

140. The view was expressed that article 11 ran counter to the principle of party autonomy and should therefore be deleted or made subject to a reservation by States. There was not sufficient support for that view in the Commission. It was widely felt that the underlying policy of article 11 should be approved. Article 11 was an essential provision agreed upon by the Working Group after a long debate. In addition, it was observed that it was more beneficial for everyone to facilitate the assignment of receivables and to reduce transaction costs rather than to ensure that the debtor would not have to pay a person other than the original creditor. It was also stated that the goal of the draft convention, which was to increase the availability of credit at more affordable rates, could not be achieved without some adjustments in national legislation that would be aimed at accommodating modern commercial practices. After discussion, the Commission approved the overall policy underlying article 11 and decided that it should be retained (subject to the changes described in paras. 144 and 151).

Avoidance of contract on the sole ground of breach of anti-assignment agreement

141. Differing views were expressed as to whether the debtor should be able to declare the original contract avoided on the sole ground of breach of the agreement limiting the assignment of receivables in any way ("anti-assignment agreement"), if the debtor had such a right under law applicable outside the convention. One view was that the convention should not interfere with the debtor's right to avoid the original contract for breach of any anti-assignment agreement. It was stated that such an approach was not necessary since avoidance of the original contract could not affect any rights acquired under that contract. In addition, it was observed that such an approach would inadvertently result in overprotecting, without any reason, not only the assignee but also the assignor, despite the fact that the assignor would have committed a breach of contract.

142. The prevailing view, however, was that, unless the debtor was precluded from declaring the original contract avoided on the sole ground that the assignor had violated an anti-assignment agreement, articles 11 and 20, paragraph 3, would be deprived of any meaning (those provisions validated an assignment made in breach of an anti-assignment agreement and precluded the debtor from raising against the assignee any right the debtor might have as against the assignor as a result of the breach of the anti-assignment agreement). In addition it was stated that if after notification the debtor could not do the minimum, namely modify the original contract without the actual or constructive consent of the assignee, the debtor should not be entitled to do the maximum, namely to avoid the original contract. Moreover, it was pointed out that, if the original contract were to be avoided, the assignee could find itself in a position of having advanced financing to the assignor while being unable to rely on payment by the debtor.

143. For that reason, the suggestions to exclude the debtor's avoidance rights with respect to all contracts except long-term contracts and future receivables or to leave paragraph 2 unchanged and to include an explanation of the matter in a commentary were not supported. Another suggestion to include in the text of article 11 or in a commentary to the convention the clarification that the avoidance of the original contract did not affect the debtor's acquired rights did not attract sufficient support either. It was widely felt that if the debtor avoided the original contract, the assignee's rights were bound to be affected. Another suggestion to limit the debtor's right to avoid the original contract for breach of an anti-assignment agreement to cases in which a material breach was involved also did not attract sufficient support. It was widely felt that such an approach would introduce uncertainty, since it might not always be clear what types of conduct constituted a material breach of contract. In any case, such an approach would not be sufficient to protect the assignee, since any type of breach could be defined in the original contract as being a material breach. It was generally agreed that any uncertainty with regard to that matter could inadvertently result in failing to cover the risk of contract avoidance and thus in defeating a transaction or in raising the cost of credit for the assignor and the debtor. Yet another suggestion to preclude the debtor from avoiding the original contract, unless the assignment "materially impaired the debtor's ability to obtain performance", was met with interest. It was proposed that language be included in paragraph 2 to implement that suggestion and to preclude the parties from defining the breach of an anti-assignment clause as a material impairment of the debtor's ability to obtain performance. An objection was raised with regard to the inclusion of the proposed text in article 11 on the ground that it might inadvertently be interpreted as implying that the convention affected non-monetary performance rights. It was agreed, however, that a commentary to the convention could clarify that an assignment under the convention could not affect any non-monetary performance rights of the debtor.

144. After discussion, the Commission agreed that paragraph 2 should be revised to preclude the debtor from avoiding the original contract on the sole ground that the assignor had made an assignment in violation of an anti-assignment agreement. It was also agreed that the same rule should apply with respect to anti-assignment agreements in assignments or subsequent assignments. Furthermore, it was agreed that the debtor's right to compensation should not be limited in any way. Subject to that change, the Commission approved the substance of paragraph 2 and referred it to the drafting group.

Scope of articles 11 and 12

145. Recalling its earlier discussion on the scope of articles 11 and 12 (see paras. 104-107), the Commission con-

sidered a suggestion to limit the scope of application of article 11 to those practices for which articles 11 and 12, paragraphs 2 and 3, would be suitable. Language along the following lines was proposed for inclusion in a new paragraph 3 of article 11 and after paragraph 3 of article 12:

"This article applies only to receivables:

"*(a)* Arising under an original contract for the sale or lease of goods or the provision of services other than financial services;

"*(b)* Arising under an original contract for the sale, lease or licence of industrial or other intellectual property or other information; or

"*(c)* Representing the payment obligation for a credit card transaction."

146. It was stated that under the proposed approach the effect of an anti-assignment agreement with respect to practices not mentioned in the proposed list would be left to law outside the convention. If that law gave effect to anti-assignment agreements, the assignment would be ineffective and thus the convention would not apply. It was observed that such an approach would make a restrictive definition of "receivable" in article 2 unnecessary and it would also make article 5 superfluous.

147. While broad support was voiced in the Commission for the proposed limitation of the scope of articles 11 and 12, paragraphs 2 and 3 (and thus of the convention), concern was expressed that the proposed approach would overly limit the scope of the convention.

148. A question was also raised as to whether "goods" would include immovable property. In response, it was observed that "goods" was meant to denote only movable tangible property and would therefore not include land or buildings or goods permanently fixed into land or buildings. The suggestion was therefore made that in subparagraph *(a)* of the proposed text reference should also be made to receivables arising from the sale or lease of real estate. In support, it was stated that there was no reason to exclude from the scope of application of articles 11 and 12, paragraphs 2 and 3, assignments of receivables arising from real estate transactions. Such an exclusion was not necessary, in particular, after the addition of a provision in article 4 aimed at protecting interests held under the law of the country in which the real estate was located. A note of caution was struck, however, that such an approach might have a negative effect on the acceptability of the convention. In response, it was pointed out that the inclusion of the proposed addition would highlight the matter and facilitate consultation with the relevant industry. After discussion, the Commission approved the proposed addition.

149. Recalling its earlier decision to exclude financial netting agreements from the scope of the draft convention as a whole (see paras. 46-48), the Commission resumed its discussion on whether industrial netting agreements should be excluded from the scope of articles 11 and 12. The suggestion was made that the assignment of receivables arising from non-financial contracts governed by netting agreements should be excluded from the scope of the two articles. Objections were raised with regard to that suggestion on the ground that such an approach could inadvertently result in excluding the assignment of a wide range of receivables merely because the assignor and the debtor had included in their original contract a clause about payment by way of set-off. It was considered that the convention should not sanction such set-off agreements, which were routinely made and were aimed at defrauding assignees. It was stated that such an approach was not necessary, since receivables from industrial netting arrangements between chambers of commerce were normally not assigned. The suggestion was made that the matter could be addressed in article 20, dealing with rights of set-off. However, it was stated that industrial netting arrangements could be preserved, without excluding from the convention important trade practices, if the application of articles 11 and 12 were to be limited to the net debt owed after the settlement of mutual debts governed by a netting agreement contained in an original contract. It was also observed that the net balance owed after the settlement of mutual obligations to the parties to a netting agreement was a new receivable arising by novation. It was pointed out that a netting agreement, under the definition adopted by the Commission, should be understood as an arrangement among, at least, three or more parties (see paras. 73 and 74). Some doubt was expressed as to whether the definition of "netting agreement" made it sufficiently clear that at least three parties were required. However, it was widely felt that the definition was sufficiently clear and should not be changed, in particular, since in some jurisdictions netting arrangements could involve only two parties. The following text was proposed for addition either in articles 11 and 12 or in article 4:

"In the case of receivables arising under contracts governed by netting agreements, articles 11 and 12, paragraphs 2 and 3, apply only to the assignment of a receivable owed to the assignor upon net settlement of payments due pursuant to the netting agreement."

There was broad support for that suggestion.

150. The suggestion was also made that articles 11 and 12, paragraphs 2 and 3, should apply "to other similar practices". That suggestion encountered an objection on the ground that it might create uncertainty as to the scope of application of the convention. Another suggestion was that in subparagraph *(a)* of the proposed text reference should be made also to construction, since in some jurisdictions the term "services" was not sufficient to include construction. Broad support was expressed in the Commission for that suggestion. Yet another suggestion was that a commentary to the convention should explain that "financial services" included factoring and invoice discounting, even if those practices involved services that were not financial in a strict sense, such as insurance, book-keeping or debt-collection services. That suggestion also attracted sufficient support.

151. After discussion, the Commission approved the substance of the proposed addition to articles 11 and 12, as revised to refer to real estate receivables, industrial netting and construction (see paras. 148-150) and referred it to the drafting group. In line with that decision, the Commission decided that articles 5 and 6, subparagraph *(l)*, should be deleted.

Further practices to be excluded

152. After completing its discussion on the scope of articles 11 and 12, the Commission reverted to the question whether States should be allowed to exclude further practices from the scope of the convention (see articles 4, para. 2, and 39, as well as paras. 32 and 109). There was strong support for the deletion of articles 4, paragraph 2, and 39. It was widely felt that, once the scope of the convention had been defined in a detailed and restrictive way, all scope-related concerns would have been addressed and therefore there was no need to allow further exclusions. It was also widely felt that allowing further exclusions on a State-by-State basis would run counter to the goal of the convention to achieve uniformity and certainty. However, the concern was expressed that deletion of articles 4, paragraph 2, and 39 might reduce the acceptability of the convention. It was also stated that it would be premature to delete article 4, paragraph 2, before the Commission had made a final decision with respect to all scope-related issues and the final provisions in their entirety. For that reason, the Commission deferred final decision on draft articles 4, paragraph 2, and 39 until it had finalized the draft convention as a whole.

Article 12. Transfer of security rights

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

"1. A personal or property right securing payment of the assigned receivable is transferred to the assignee without a new act of transfer, unless, under the law governing the right, it is transferable only with a new act of transfer. If such a right, under the law governing it, is transferable only with a new act of transfer, the assignor is obliged to transfer this right and any proceeds to the assignee.

"2. A right securing payment of the assigned receivable is transferred under paragraph 1 of this article notwithstanding an agreement between the assignor and the debtor or other person granting the right, limiting in any way the assignor's right to assign the receivable or the right securing payment of the assigned receivable.

"3. Nothing in this article affects any obligation or liability of the assignor for breach of an agreement under paragraph 2 of this article. A person who is not a party to such an agreement is not liable on the sole ground that it had knowledge of the agreement.

"4. 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.

"5. 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 receivable."

Paragraph 1

154. The Commission noted that the second part of the first sentence of paragraph 1 repeated in effect the second sentence of paragraph 1 and should therefore be deleted. Subject to that change, the Commission approved the substance of paragraph 1 and referred it to the drafting group.

Paragraphs 2 and 3

155. Recalling its decision that the debtor should not be able to declare the original contract avoided on the sole ground that the assignor violated an anti-assignment clause (see para. 144), the Commission decided that the same rule should apply with respect to a breach of an agreement to assign a right securing payment of a receivable. Subject to that change in paragraph 2, the Commission approved the substance of paragraphs 2 and 3 and referred them to the drafting group.

156. The Commission also recalled its decision with respect to the scope of article 11 (see para. 151) and decided that paragraphs 2 and 3, which followed the language of article 11, should have the same scope as article 11. It was therefore decided that a new paragraph dealing with the scope of paragraphs 2 and 3 along the lines of the scope provision in article 11 should be inserted as paragraph 4 of article 12.

Paragraphs 4 and 5

157. The Commission approved the substance of paragraphs 4 and 5 unchanged. It was noted that paragraph 5 was consistent, and did not need to be aligned, with the new safe-haven rule on the form of assignment. As a result of a combined application of the new rule and article 12, paragraph 5, the form of assignment would be subject to the law of the assignor's location (or any other applicable law), while the form of the transfer of a right securing payment of the assigned receivable would be subject to the law governing that right.

CHAPTER IV. RIGHTS, OBLIGATIONS AND DEFENCES

Section I. Assignor and assignee

Article 13. Rights and obligations of the assignor and the assignee

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

"1. The rights and obligations of the assignor and the assignee as between them 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."

159. It was noted that, in view of the fact that party autonomy was broadly recognized in paragraph 1, parties would always have the right to agree otherwise as to the binding nature of practices established between themselves. As a result, it was noted, the words "unless otherwise agreed" in paragraph 2 were not necessary. It was also noted that those words might raise questions of interpretation, since the equivalent provision in article 9, paragraph 1, of the United Nations Sales Convention did not contain such wording. The Commission agreed, however, that the matter was sufficiently clear and decided to retain the words "unless otherwise agreed", since the reference to practices might otherwise create uncertainty.

160. It was noted that, after the limitation of article 13 to the mutual rights and obligations of the parties, the reason for departing in paragraph 5 from the wording of the equivalent provision of the United Nations Sales Convention (article 9, paragraph 2) had ceased to exist and therefore reference to what the parties knew or ought to have known would not create any problems for third parties. However, the Commission agreed that paragraph 5 was satisfactory in its current formulation.

161. After discussion, the Commission approved the substance of article 13 unchanged and referred it to the drafting group. Pending final determination of the title, the preamble and article 6 *(c)*, the Commission deferred a decision with regard to the words "receivables financing" in paragraph 3 (see para. 184).

Article 14. Representations of the assignor

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

"1. Unless otherwise agreed between the assignor and the assignee, the assignor represents at the time of the conclusion 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."

163. The Commission approved the substance of article 14 unchanged and referred it to the drafting group. It was widely felt that paragraph 1 *(a)* was sufficient to cover all representations relating to the existence of the receivable, since, if the receivable did not exist or was subject to a statutory limitation, the assignor would not have the right to assign it. It was also generally agreed that it was not necessary to add representations as to the non-modification of the original contract after notification, without the actual or constructive consent of the assignee, or to the transfer of any independent security or other supporting rights by the assignor to the assignee, since those matters were sufficiently covered by party autonomy and draft articles 12, paragraph 1, and 22, paragraph 2.

Article 15. Right to notify the debtor

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

"1. Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor a notification of the assignment and a payment instruction, but after notification is sent only the assignee may send a payment instruction.

"2. A notification of the assignment or payment instruction sent in breach of any agreement referred to in paragraph 1 of this article is not ineffective for the purposes of article 19 by reason of such breach. 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."

165. The Commission approved the substance of article 15 unchanged and referred it to the drafting group.

Article 16. Right to payment

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

"1. As between the assignor and the assignee, unless otherwise agreed, and whether or not a notification of the assignment has been sent:

"*(a)* If payment in respect of the assigned receivable is made to the assignee, the assignee is entitled to retain the proceeds and goods returned in respect of the assigned receivable;

"*(b)* If payment in respect of the assigned receivable is made to the assignor, the assignee is entitled to payment of the proceeds and is also entitled to goods returned to the assignor in respect of the assigned receivable; and

"*(c)* If payment in respect of the assigned receivable is made to another person over whom the assignee has priority, the assignee is entitled to payment of the proceeds and is also entitled to goods returned to such person in respect of the assigned receivable.

"2. The assignee may not retain more than the value of its right in the receivable."

167. The Commission approved the substance of article 16 unchanged. It was agreed that the draft article properly covered proceeds, including returned goods, and that the definition of proceeds should be reviewed in the context of articles 24 and 26.

Section II. Debtor

Article 17. Principle of debtor protection

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

"1. Except as otherwise provided in this Convention, an assignment does not, without the consent of the debtor, affect the rights and obligations of the debtor, including the payment terms contained in the original contract.

"2. A payment instruction may change the person, address or account to which the debtor is required to make payment, but may not:

"*(a)* Change the currency of payment specified in the original contract; or

"*(b)* Change the State specified in the original contract, in which payment is to be made, to a State other than that in which the debtor is located."

Change of country of payment

169. The Commission considered whether any change of the country of payment, even to the country in which the debtor was located, should be subject to the debtor's consent. It was stated that paragraph 2 *(b)* was sufficient to cover the vast majority of cases, in which payment in the debtor's country, instead of in the country of a foreign assignor, would be agreeable to the debtor. It was also observed that such an approach appropriately reflected a good practice, in particular, in international factoring contracts, and the convention should avoid casting any doubt on that practice. In addition, it was observed that the convention did not need to address the very special cases in which a debtor might prefer to pay in a foreign country. On the other hand, it was stated that any change to the country of payment should be subject to the debtor's consent, since the debtor might have good reasons for agreeing in the original contract to pay in a foreign country. In addition, it was stated that, if the assignee and the debtor were to be able to change by agreement the country of payment, they should also be able to change the currency of payment. On the understanding that agreements between assignees and debtors fell outside the scope of the convention, the Commission decided that no change was necessary in paragraph 2.

Consumer protection

170. It was noted that a principle flowing from article 17 was that the convention was not intended to affect adversely the legal position of consumer debtors. It was also noted that that general principle was also reflected in articles 1, paragraph 2 (which provided that the convention would not affect the debtor's legal position unless the debtor was located in a contracting State or the law governing the receivable was the law of a contracting State), 9 as revised (which made clear that the convention was not intended to affect limitations on assignment imposed by law, other than those referred to in article 9), 19 (which allowed the debtor to discharge its obligation under law outside the convention), 20 (which preserved the debtor's defences and rights of set-off, with the exception of rights of set-off arising from unrelated contracts and not available at the time of notification), 21 and 23 (which made explicit reference to consumer protection law) and 22 (which allowed a modification of the original contract, even after notification, with the constructive consent of the assignee).

171. The view was expressed that, in order to avoid any doubt, the above-mentioned understanding should be explicitly mentioned in article 17. It was stated that consumer protection legislation reflected public policy, at both the national level and the supranational level, with which the convention could not and should not interfere. It was stated that such legislation was aimed at protecting consumer debtors, in view of the fact that they normally did not have the bargaining power to protect their interests, and it could not be derogated from by agreement of the parties since it was of a mandatory nature. In addition, clauses involving implicit consent by the consumer could be interpreted as abusive clauses prohibited by rules of law enacted under international agreements on regional integration. The following language was proposed for addition to article 17 (see A/CN.9/472, p. 10). "This Convention does not prejudice the laws of the State in which the debtor is located governing the protection of the debtor in transactions made for personal, family or household purposes."

172. Objections were raised with regard to the above-mentioned suggestion. It was stated that the proposed wording was unnecessary, since the draft convention already contained appropriate provisions protecting the interests of consumer debtors. It was also observed that the proposed wording might raise questions of interpretation or even invite courts to invalidate assignments on obscure or artificial grounds, a result that could undermine the availability or the cost of consumer credit. On the other hand, it was pointed out that the difference between the positions reflected above might not be so significant. In that vein, it was suggested that the wording of article 17 should make it clear that the draft convention would not permit a consumer debtor to vary or derogate from the original contract if the derogation or variation was not permitted by consumer-protection legislation in the State in which the debtor was located. While some support was expressed for that suggestion, the Commission approved the substance of article 17 unchanged and referred it to the drafting group, on the understanding that it might have to reconsider the matter.

Legal position of the debtor in the case of a partial assignment

173. It was recalled that the Commission had decided to postpone discussion of the legal position of the debtor in the case of one or more notifications with respect to a partial assignment until it had a chance to consider the debtor-related provisions (see para. 20). The view was expressed that the matter should be dealt with in article 17. However, the Commission did not have sufficient time to consider the matter (see paras. 180 and 185).

CHAPTER V. CONFLICT OF LAWS

174. The Commission heard a statement on behalf of the Permanent Bureau of the Hague Conference on Private International Law, which was aimed at ensuring close cooperation with UNCITRAL. It was recalled that a joint group of UNCITRAL and Hague Conference experts had met in The Hague from 18 to 20 May 1998 and that subsequently the Permanent Bureau of the Hague Conference had submitted a report dated 10 July 1998 containing several recommendations to the relevant UNCITRAL Working Group (A/CN.9/WG.II/WP.99). It was observed that, while articles 24-27 did not fully implement the recommendations contained in the report by the Permanent Bureau, they were in principle entirely satisfactory.

175. With regard to chapter V, it was pointed out that, if adopted with a broader scope than that of the convention (i.e. as a "mini-convention"), it might be in conflict with regional texts, such as the European Union Convention on the Law Applicable to Contractual Obligations (Rome, 1980; "the Rome Convention"). In that connection, it was pointed out that draft article 28 departed from article 12 of the Rome Convention in two respects: it required an explicit choice of law and created a rebuttable presumption in favour of the law of the assignor's location as the law most closely connected to the contract of assignment. It was also observed that, in principle, it would not be appropriate to subject the application of chapter V to the notion of internationality of the substantive law part of the draft convention. However, if that approach were to be confirmed by the Commission, draft article 28, paragraph 3 (precluding the application of a foreign law chosen by the parties to a domestic assignment of domestic receivables), might not be necessary, since, if an assignment were not international under draft article 3, chapter V would not apply. With regard to draft articles 30-32, some doubt was expressed as to whether they were necessary. It was also observed that draft article 30, paragraph 2, appeared to repeat the rule contained in draft article 32. In addition, it was stated that the issue of the scope of chapter V and the hierarchy between chapter V and the rest of the draft convention would need to be resolved in a separate article, as suggested by the UNCITRAL secretariat (see A/CN.9/470, para. 22). Moreover, the issue of renvoi would need to be resolved by way of a provision in chapter V, since, if chapter V were to have a broader scope of application than the rest of the draft convention, draft article 6 *(j)* (which was intended to address the issue of renvoi) would not apply.

176. In response, it was stated that chapter V might not be a "mini-convention" and, if it were to become one, articles 28 and 29 might need to be redrafted and a provision on renvoi might need to be included in chapter V. It was also observed that, if chapter V applied to assignments with an international element as defined in article 3, article 28, paragraph 3, would not be necessary.

177. The Commission was also informed of a proposal presented to the Special Commission on general affairs and policy of the Conference at its meeting held in The Hague from 8 to 12 May 2000, for the Hague Conference to prepare a draft convention on the law applicable to security interests in investment securities. It was stated that close cooperation with UNCITRAL would be particularly welcome, in view of the Commission's work on assignment of receivables and the possibility of UNCITRAL undertaking further work in the future in the field of secured credit law.

178. The Commission expressed its appreciation to the observer for the Permanent Bureau of the Hague Conference and deferred discussion on chapter V until it had finalized the substantive law part of the draft convention. Discussion on possible future work in the field of secured credit law was postponed until the Commission had considered agenda item 16, "Coordination and cooperation" (see paras. 455–463).

C. Report of the drafting group

179. The Commission requested a drafting group established by the secretariat to review articles 1-17 of the draft convention, with a view to ensuring consistency between the various language versions.

180. At the close of its deliberations on the draft convention, the Commission considered the report of the drafting group and adopted articles 1-17 of the draft convention, as revised by the drafting group, with the exception of the bracketed language in those provisions and of article 1, paragraph 5, which was left to be considered in the context of a discussion on draft article 40 and the annex to the draft convention. Article 7, paragraph 2 (article 8 in the text of the draft convention considered by the Commission), was adopted subject to consideration of the question of its relationship with chapter V. Article 17 was adopted subject to consideration of whether the issue of the legal position of the debtor in the case of a partial assignment should be explicitly addressed in article 17, a question which the Commission did not have sufficient time to consider (see paras. 20, 173 and 185).

181. In the context of the discussion of the report of the drafting group, the Commission decided that the title of the convention should read: "Convention on Assignment of Receivables in International Trade". It was widely felt that any reference to "receivables financing" would be inconsistent with the scope of the convention, which went beyond purely financing transactions. In the discussion, the suggestion was made that the words "in International Trade" should be deleted, since they were not necessary and might be misleading to the extent that they suggested that only the assignment of trade receivables was covered. It was agreed that those words could be retained, while a commentary to the convention could explain that the term "international trade" was used in the widest possible sense and that in any case it was intended to include trade, financial and consumer transactions.

182. Following up on its decision to delete the reference to "receivables financing" in the title of the convention, the Commission decided to delete any reference to financing in the preamble. With regard to the second preambular paragraph, it was decided that reference should be made to uncertainties constituting an obstacle to international trade. As to the third preambular paragraph, while some support was expressed for the retention of the indicative list of

practices, it was decided that the list should be deleted, since it was bound to be incomplete and could soon become outdated. It was also agreed that the main practices to be covered by the convention should be highlighted at the beginning of a commentary to the convention. With regard to the fourth preambular paragraph, the suggestion was made that it should include a reference to the preservation of national law, in particular with regard to preferential rights and rights in real estate. It was agreed that the reference to the preservation of the debtor's rights was sufficient in that respect and that a commentary could further explain the types of debtor's rights and the kind of laws intended to be preserved. It was noted that such an approach would be consistent with the approach taken in the preamble to the UNCITRAL Model Law on Cross-Border Insolvency. As to the fifth preambular paragraph, it was agreed that the reference to "capital and credit" should be retained so as to clarify that the convention was intended to cover both outright assignments (in which capital was made available) and assignments by way of security (in which credit was made available). It was also agreed that reference should be made first to the availability of capital and credit and then to international trade.

183. After discussion, the Commission decided that the preamble should read as follows:

"*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 content and the choice of legal regime applicable to assignments of receivables constitute an obstacle to international trade,

"*Desiring* to establish principles and adopt rules relating to the assignment of receivables that would create certainty and transparency and promote modernization of law relating to assignments of receivables, while protecting existing assignment practices and facilitating the development of new practices,

"*Desiring also* to ensure the adequate protection of the interests of the debtor in the case of an assignment of receivables,

"*Being of the opinion* that the adoption of uniform rules governing assignments of receivables would promote the availability of capital and credit at more affordable rates and thus facilitate the development of international trade,

"*Have agreed* as follows:"

184. In line with its decision to delete any references to "receivables financing" in the title and the preamble to the convention, the Commission decided that article 6, subparagraph *(c)*, and the reference to "receivables financing" in article 13, paragraph 3, should also be deleted.

185. In view of the fact that, under article 2, the scope of the convention would be limited to contractual receivables, it was stated that the question whether States should be given a right to apply the convention to additional practices (e.g. to assignments of non-contractual receivables) should be reconsidered in the context of the final provisions. With respect to draft article 4, paragraph 1 *(b)*, it was agreed that the words "to the extent" should be deleted. As to draft article 4, paragraph 3 *(a)* and *(b)*, it was agreed that the subparagraphs should be merged, reference should be made to competing rights and the word "or" after subparagraph *(b)* should be deleted. As to draft article 4, paragraph 2 *(f)*, it was suggested that the French version should refer to "*valeurs mobiliers*". With respect to draft articles 11, paragraph 3 *(a)*, and 12, paragraph 4 *(a)*, it was agreed that the word "goods" should be placed in square brackets, pending a decision as to whether the word "goods" included intangible movable property. With respect to article 17, it was agreed that the question of the legal position of the debtor in the case of notifications relating to partial assignments remained to be addressed in the future (see also paras. 20, 173 and 180).

D. Future work on the draft convention

186. Having adopted the report of the drafting group, the Commission considered the steps to be taken for the completion of its work on the draft convention. A proposal was made and supported by several delegations that a resumed session of the Commission should be convened for that purpose before the end of the year or early in 2001. This would have the advantage of allowing the Commission to complete its work in a timely fashion while avoiding sending the draft convention back to a working group and risking the reopening of matters already settled by the Commission. The prevailing view, however, was that the draft convention should be referred back to a working group. It was widely felt that such an approach would ensure the optimal use of the resources available to the Commission and allow it to complete its work on the draft convention in 2001 without having to change radically its schedule of meetings or general programme of work. It was stated that the changes made in articles 1-17 created a new situation, which would need to be reviewed by the Working Group on International Contract Practices. It was also observed that, in view of the Working Group's familiarity with the text, its expertise and efficiency, the draft convention could be advanced to a point where it could be swiftly adopted by the Commission at its 2001 session. In that connection, the Commission reaffirmed its confidence in the Working Group and expressed its appreciation for the remarkable work it had accomplished during the eight sessions devoted to the draft convention from November 1995 to October 1999.

187. As to the terms of reference of the Working Group, the Commission considered a proposal that read as follows:

"1. Beginning with draft article 18, the Working Group should review those parts of the draft convention that the Commission has not had the opportunity to examine and text that remained within square brackets in draft articles 1-17.

"2. In the light of modifications to draft articles 1-17, the Working Group should ensure that the coherence and consistency of the text are maintained.

"3. If, as a result of its consideration of draft articles 18 of the draft convention to draft article 7 of the annex, the Working Group identifies issues in draft articles 1-17, it

should bring those issues to the attention of the Commission with an appropriate explanation and recommendation, if possible.

"4. As to its working methods, the Working Group should adopt the same approach as the Commission, that is, it should make only those changes that meet with substantial support."

188. Strong support was expressed for the proposal. It was widely felt that the proposed terms of reference would ensure that the mandate of the Working Group was both firm, ensuring that the Working Group would not change policy decisions made by the Commission, and flexible, allowing the Working Group to consider all issues not settled by the Commission and effect purely drafting changes in draft articles 1-17. In order to clarify the point that the Working Group should not reopen discussion on policy issues settled by the Commission, it was suggested that paragraphs 2 and 4 of the above-mentioned terms of reference should be prefaced by the words "In reviewing draft articles 18 of the draft convention to draft article 7 of the annex". However, it was agreed that that change was not necessary, since the current wording made it sufficiently clear that the Working Group did not have the mandate to effect any change in the policy decisions made by the Commission. If the Working Group identified any new policy issues relating to articles 1-17, it could only bring them to the attention of the Commission, making recommendations for their resolution by the Commission. On that basis, the Commission approved the terms of reference mentioned above and referred the draft convention to a working group to be convened before the end of the year, with the request that the working group proceed with its work expeditiously so as to finalize the draft convention and submit it for adoption by the Commission at its next session, in 2001.

189. The Commission next considered the procedure for final adoption of the draft convention and opening for signature by States. The view was expressed that it would be premature for the Commission to consider the matter at the current session. The prevailing view, however, was that the Commission should inform the General Assembly of the possibility of the final adoption of the draft convention by the Assembly at its fifty-sixth session, in 2001, or by a diplomatic conference to be convened as soon as possible after the adoption of the draft convention by the Commission at its thirty-fourth session. Such a recommendation would allow the Sixth Committee of the General Assembly to consider the matter and take any necessary action. It would also allow the Fifth Committee to consider whether a diplomatic conference could be held within existing resources and thus keep open for the Commission the option of deciding at its thirty-fourth session to refer the draft convention to a diplomatic conference. It was understood that authorization of a diplomatic conference by the General Assembly would be subject, in addition to approval by the Fifth and Sixth Committees, to an offer by a Government to host the conference, accepting to bear the costs of changing the venue of the conference from Vienna, the seat of the secretariat of UNCITRAL, to a city in the host country. The Commission deferred a decision on the matter until it had considered a draft recommendation to the General Assembly (see para. 192).

190. The Commission next turned to the question whether a commentary should be prepared on the convention. It was noted that a commentary could be official, in which case it would need to be reviewed in detail and approved by the Commission, or unofficial, in which case it could be prepared by the secretariat on the basis of general instructions given by the Commission. It was also noted that, regardless of whether the commentary were to be official or unofficial, the Commission would need to consider whether the purpose of the commentary would be to assist legislators in their consideration of the draft convention for adoption or users of the convention in the application and interpretation of it, or whether the commentary should be cast as both a legislative guide and a tool for interpretation. It was generally agreed that a commentary should be prepared by the secretariat in order to assist legislators in considering the draft convention for adoption and users of the convention in interpreting and applying it. It was stated that the analytical commentary contained in the note by the secretariat of 23 May 2000 (A/CN.9/470) could serve as an excellent basis for such a commentary, which, however, should be more concise and succinct. In response to a question, it was noted that it would be more efficient if the revised version of the commentary were to be prepared after the Working Group had completed its consideration of the draft convention, since otherwise the first part of the commentary, on articles 1-17, would probably need to be revised again after the Working Group had completed its work. In any case, it was widely felt that the Working Group would not have time to consider the commentary. It was agreed, however, that, if necessary, the secretariat could prepare a note bringing to the attention of the Working Group any issues to be addressed by the Group.

191. After discussion, the Commission requested the secretariat to prepare and distribute a revised version of the commentary on the convention after the Working Group had completed its work on the draft convention (for the dates of the next session of the Working Group on International Contract Practices, see para. 469). It was agreed that the commentary should be concise and serve as an unofficial legislative guide and a tool for the interpretation of the convention. The Commission also requested the secretariat to distribute for comments the text of the draft convention after the completion of the work of the Working Group to all States and interested international organizations, including non-governmental organizations that were normally invited to attend meetings of the Commission and its working groups as observers, and to prepare an analytical compilation of those comments.

192. At the close of its deliberations on the draft convention, the Commission adopted the following recommendation to the General Assembly:

"*The United Nations Commission on International Trade Law*,

"*Noting* that it is expected to adopt the draft Convention on Assignment of Receivables in International Trade at its thirty-fourth session, in 2001,

"*Bearing in mind* that, at that session, it will have to submit a recommendation to the General Assembly as to the procedure for the conclusion of the draft Convention,

"*Recognizing* the importance of concluding the work on the draft Convention in a timely manner,

"1. *Recommends* that the General Assembly include an item entitled 'Conclusion of the draft Convention on Assignment of Receivables in International Trade' in the agenda of its fifty-sixth session, in 2001, with a view to concluding the draft Convention itself or referring it to a conference of plenipotentiaries to be convened in 2002;

"2. *Also recommends* that, if the Commission decides to recommend the holding of a Conference, the General Assembly request the Secretary-General to distribute the draft Convention, as early as possible after its finalization by the Commission at its thirty-fourth session, in 2001, for comments by States and international organizations, including non-governmental organizations normally invited to attend meetings of the Commission as observers."

IV. PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

A. General remarks

193. At the outset of its consideration of the draft chapters of a legislative guide on privately financed infrastructure projects, the Commission noted that earlier drafts of all chapters of the legislative guide had been considered by the Commission at its thirty-second session, in 1999 (A/CN.9/458/Add.1-9). Some of the chapters had also been considered at the Commission's thirtieth session, in 1997 (A/CN.9/438/ Add.1-3), and at its thirty-first session, in 1998 (A/CN.9/444/Add.1-5).

194. Given the advanced stage of preparation of the draft chapters and the extensive deliberations that had taken place at the earlier sessions, it was decided that at the current session the Commission should focus its attention on the legislative recommendations (as contained in the consolidated list of legislative recommendations in A/CN.9/471/Add.9). The Commission was invited to turn to the notes on the legislative recommendations only when that would be necessary to establish whether the notes accurately reflected the deliberations in the Commission at its thirty-second session (and reflected in the relevant part of its report on the session)[3] or when a modification to the notes would be necessary as a result of decisions regarding the draft legislative recommendations. (For the subsequent discussions regarding the finalization of the guide and possible future work in the area of privately financed infrastructure projects, see paras. 375-379 below.)

B. Consideration of draft legislative recommendations

Suggestion for addition of a general legislative recommendation

195. A suggestion was made to introduce, at the beginning of the list of legislative recommendations or at another appropriate place, a note of caution to legislators not to restrict overly the freedom of the parties to shape the project agreement since that would make it more difficult to negotiate or implement privately financed infrastructure projects. While it was agreed that the suggestion was based on valid reasoning, the general opinion was that such a note of caution or recommendation should not be added. One reason given was that the legislative recommendations in their totality had to reflect the appropriate balance between freedom of the parties and restrictions needed to protect the public interest. Another reason was that such general advice was by nature not precise and therefore of limited utility, and might even cause difficulty or confusion if it were to be used in interpreting legislative recommendations in the guide.

196. The Commission adopted the *chapeau* to the legislative recommendations, which appeared before recommendation 1, and read as follows:

"For host countries wishing to promote privately financed infrastructure projects it is recommended that the following principles be implemented by the law:"

CHAPTER I. GENERAL LEGISLATIVE AND INSTITUTIONAL FRAMEWORK

Constitutional and legislative framework

197. The Commission postponed its decision on a suggestion to incorporate chapter VII. "Other relevant areas of law", into chapter I, "General legislative and institutional framework" (see para. 369).

Recommendation 1

198. The text of the draft recommendation was as follows:

"The legislative and institutional framework for the implementation of privately financed infrastructure projects should ensure transparency, fairness and the long-term sustainability of projects. Undesirable restrictions on private sector participation in infrastructure development and operation should be eliminated."

199. In order to reflect the breadth of the recommendation and to align the title with the content of the recommendation, it was decided to expand the title to read "Constitutional, legislative and institutional framework" and the opening words of the recommendation to read "The constitutional, legislative and institutional framework". Subject to those changes, the Commission adopted recommendation 1.

Scope of authority to award concessions

Recommendation 2

200. The text of the draft recommendation was as follows:

"The law should identify the public authorities of the host country (including, as appropriate, national, provin-

[3] *Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17* (A/54/17), paras. 12-307.

cial and local authorities) that are empowered to enter into agreements for the implementation of privately financed infrastructure projects."

201. The Commission adopted recommendation 2 to insert the words "to award the concession and" between the words "that are empowered" and the words "to enter into agreements".

Recommendation 3

202. The text of the draft recommendation was as follows:

"Privately financed infrastructure projects may include concessions for the construction and operation of new infrastructure facilities and systems or the maintenance, modernization, expansion and operation of existing infrastructure facilities and systems."

203. Proposals were made to expand the recommendation by adding references to "ownership" of the infrastructure facility and "financing". The proposals did not receive sufficient support on the ground that adding those details might require the addition of other details. Furthermore, whether and to what extent a concession involved ownership of the infrastructure concerned was a matter related to the various policy options available to the host country, which were discussed in the notes. The Commission adopted recommendation 3.

Recommendation 4

204. The text of the draft recommendation was as follows:

"The law should identify the sectors or types of infrastructure in respect of which concessions may be granted."

205. The opinion was expressed that the recommendation envisioned an exhaustive list of sectors or types of infrastructure where concessions might be granted. In that light, a proposal was made to reformulate the recommendation to express the idea that the legislator should set out only a priority list of such sectors or types of infrastructure. In support of the proposal, it was stated that governmental priorities as to the sectors in which concessions might be granted might change over time and that, by having an exhaustive list of sectors in the law, the Government would unnecessarily limit itself in fostering the development of infrastructure.

206. The Commission did not adopt the proposal and noted that it was indicated in paragraph 18 of the accompanying notes that there was more than one possible way of indicating sectors or types of infrastructure in respect of which concessions might be granted. The Commission adopted recommendation 4.

Recommendation 5

207. The text of the draft recommendation was as follows:

"The law should specify the extent to which a concession might extend to the entire region under the jurisdiction of the respective contracting authority, to a geographical subdivision thereof or to a discrete project, and whether it might be awarded with or without exclusivity, as appropriate, in accordance with rules and principles of law, statutory provisions, regulations and policies applying to the sector concerned. Contracting authorities might be jointly empowered to award concessions beyond a single jurisdiction."

208. The Commission adopted recommendation 5.

Recommendation 6

209. The text of the draft recommendation was as follows:

"Institutional mechanisms should be established to coordinate the activities of the public authorities responsible for issuing approvals, licences, permits or authorizations required for the implementation of privately financed infrastructure projects in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned."

210. The Commission adopted recommendation 6.

Recommendation 7

211. The text of the draft recommendation was as follows:

"The authority to regulate infrastructure services should not be entrusted to entities that directly or indirectly provide infrastructure services."

212. The Commission adopted recommendation 7.

Recommendation 8

213. The text of the draft recommendation was as follows:

"Regulatory competence should be entrusted to functionally independent bodies with a level of autonomy sufficient to ensure that their decisions are taken without political interference or inappropriate pressures from infrastructure operators and public service providers."

214. The Commission adopted recommendation 8.

Recommendation 9

215. The text of the draft recommendation was as follows:

"The rules governing regulatory procedures should be made public. Regulatory decisions should state the reasons on which they are based and should be accessible to interested parties through publication or other means."

216. The Commission adopted recommendation 9.

Recommendation 10

217. The text of the draft recommendation was as follows:

"The law should establish transparent procedures whereby the concessionaire may request a review of regulatory decisions by an independent and impartial body and should set forth the grounds on which a request for review may be based and the availability of court review."

218. The Commission adopted recommendation 10 subject to editorial review of its wording.

Recommendation 11

219. The text of the draft recommendation was as follows:

"Where appropriate, special procedures should be established for handling disputes among public service providers concerning alleged violations of laws and regulations governing the relevant sector."

220. The Commission adopted recommendation 11.

CHAPTER II. PROJECT RISKS AND GOVERNMENT SUPPORT

Recommendation 12

221. The text of the draft recommendation was as follows:

"No unnecessary statutory or regulatory limitations should be placed upon the contracting authority's ability to agree on an allocation of risks that is suited to the needs of the project."

222. The Commission adopted recommendation 12.

Recommendation 13

223. The text of the draft recommendation was as follows:

"The law should clearly state which public authorities of the host country may provide financial or economic support to the implementation of privately financed infrastructure projects and which types of support they are authorized to provide."

224. The suggestion was made to add after the words "types of support" the words "including public loans and guarantees, equity participation, subsidies and sovereign guarantees and assurances" to reflect better and more completely the legislative advice that was discussed in the notes. Furthermore, it was stated that it should be made clearer that various authorities in a State might grant public support to a given privately financed infrastructure project. The Commission adopted recommendation 13 without the suggested additions since it was generally felt that both points were sufficiently covered in the notes (A/CN.9/471/Add.3, paras. 30-60).

CHAPTER III. SELECTION OF THE CONCESSIONAIRE

General considerations

Recommendation 14

225. The text of the draft recommendation was as follows:

"The law should provide for the selection of the concessionaire through transparent and efficient competitive procedures adapted to the particular needs of privately financed infrastructure projects."

226. By way of a general comment, it was pointed out that chapter III contained an extensive set of legislative recommendations and detailed notes thereon. In that connection, the question was raised as to whether it was recommended that the host country should adopt specific legislation dealing with the procedures for selecting the concessionaire.

227. In response, it was noted that the purpose of the legislative recommendations was to assist the host country in developing rules specially suited for the selection of the concessionaire. The recommendations were concerned with the particular needs of privately financed infrastructure projects and differed in many respects from general rules on government procurement, such as those contained in the UNCITRAL Model Law on Procurement of Goods, Construction and Services. However, the recommendations were not intended to replace or reproduce such general rules on government procurement and it was for each host country to decide in which manner they could best be implemented. For example, a State might wish to enact special regulations dealing only with the selection of the concessionaire or might incorporate some of them into general legislation on privately financed infrastructure projects, with cross-references, as appropriate, to other legislation dealing with matters not covered in the recommendations (such as administrative and practical arrangements for conducting the selection proceedings).

228. Besides terminological suggestions accepted by the Commission to ensure consistency among the language versions (i.e. using the term "*procédure de mise en compétition*" instead of "*procédure ouverte*" in the French text), no further comments were made and the Commission adopted recommendation 14.

Pre-selection of bidders

Recommendation 15

229. The text of the draft recommendation was as follows:

"The bidders should demonstrate that they meet the pre-selection criteria the contracting authority considers appropriate for the particular project, including:

"*(a)* Adequate professional and technical qualifications, human resources, equipment and other physical facilities as necessary to carry out all the phases of the

project, namely, engineering, construction, operation and maintenance;

"*(b)* Sufficient ability to manage the financial aspects of the project and capability to sustain the financing requirements for the engineering, construction and operational phases of the project;

"*(c)* Appropriate managerial and organizational capability, reliability and experience, including previous experience in operating public infrastructure."

230. The Commission adopted recommendation 15.

Recommendation 16

231. The text of the draft recommendation was as follows:

"The bidders should be allowed to form consortia to submit proposals, provided that each member of a pre-selected consortium may participate, either directly or through subsidiary companies, in only one bidding consortium."

232. It was suggested that recommendation 16 should state that the bidders should be authorized to form consortia both for the purpose of submitting proposals and for execution of the project. However, noting that the provision dealt only with issues related to the selection process, the Commission adopted recommendation 16 without the proposed amendment.

Recommendation 17

233. The text of the draft recommendation was as follows:

"The contracting authority should draw up a shortlist of the pre-selected bidders which will subsequently be invited to submit proposals upon completion of the pre-selection phase."

234. The Commission adopted recommendation 17.

Procedure for requesting proposals

Recommendation 18

235. The text of the draft recommendation was as follows:

"Upon completion of the pre-selection proceedings, the contracting authority should invite the pre-selected bidders to submit final proposals."

236. Subject to substituting the word "request" for the word "invite", the Commission adopted recommendation 18.

Recommendation 19

237. The text of the draft recommendation was as follows:

"Notwithstanding the above, the contracting authority may use a two-stage procedure to request proposals from pre-selected bidders when it is not feasible for the contracting authority to formulate project specifications or performance indicators and contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated. Where a two-stage procedure is used, the following provisions apply:

"*(a)* The contracting authority should first call upon the pre-selected bidders to submit proposals relating to output specifications and other characteristics of the project as well as to the proposed contractual terms;

"*(b)* The contracting authority may convene a meeting of bidders to clarify questions concerning the initial request for proposals;

"*(c)* Following examination of the proposals received, the contracting authority may review and, as appropriate, revise the initial project specifications and contractual terms prior to issuing a final request for proposals."

238. The suggestion was made that the recommendation should refer to the contracting authority's obligation to keep minutes of meetings with bidders. The Commission felt, however, that the matter would best be left to the notes on the legislative recommendation and adopted recommendation 19 unchanged.

Recommendation 20

239. The text of the draft recommendation was as follows:

"The final request for proposals should include at least the following:

"*(a)* General information as may be required by the bidders in order to prepare and submit their proposals;

"*(b)* Project specifications and performance indicators, as appropriate, including the contracting authority's requirements regarding safety and security standards and environmental protection;

"*(c)* The contractual terms proposed by the contracting authority;

"*(d)* The criteria for evaluating the proposals, the relative weight to be accorded to each such criterion and the manner in which criteria are to be applied in the evaluation of proposals."

240. The Commission adopted recommendation 20.

Recommendation 21

241. The text of the draft recommendation was as follows:

"The contracting authority may, whether on its own initiative or as a result of a request for clarification by a bidder, modify the final request for proposals by issuing addenda at a reasonable time prior to the deadline for submission of proposals."

242. The Commission adopted recommendation 21.

Recommendation 22

243. The text of the draft recommendation was as follows:

"The criteria for the evaluation and comparison of the technical proposals should concern the effectiveness of the proposal submitted by the bidder in meeting the needs of the contracting authority, including the following:

"*(a)* Technical soundness;

"*(b)* Operational feasibility;

"*(c)* Quality of services and measures to ensure their continuity;

"*(d)* Social and economic development potential offered by the proposals."

244. After having considered various proposals made in connection with recommendation 23 (see paras. 248-250), the Commission adopted recommendation 22.

Recommendation .23

245. The text of the draft recommendation was as follows:

"The criteria for the evaluation and comparison of the financial and commercial proposals may include, as appropriate:

"*(a)* The present value of the proposed tolls, fees and other charges over the concession period;

"*(b)* The present value of the proposed direct payments by the contracting authority, if any;

"*(c)* The costs for design and construction activities, annual operation and maintenance costs, present value of capital costs and operating and maintenance costs;

"*(d)* The extent of financial support, if any, expected from the Government;

"*(e)* Soundness of the proposed financial arrangements;

"*(f)* The extent of acceptance of the proposed contractual terms."

246. The Commission agreed to insert the words ", unit prices" before the words "and other charges" in subparagraph *(a)*.

247. In response to a query as to the difference between subparagraphs *(b)* and *(d)*, it was explained that subparagraph *(b)* was concerned with direct payments expected from the contracting authority for goods or services actually provided or made available by the concessionaire. Subparagraph *(d)*, in turn, was concerned with financial support, such as loans, subsidies or guarantees provided by the Government, and not necessarily the contracting authority.

248. The Commission considered proposals for rearranging items listed in the recommendations. It was pointed out that assessing the soundness of the proposed financial arrangements was the very purpose of the evaluation of the financial proposals, rather than an evaluation criterion, and that therefore the substance of subparagraph *(e)* should be incorporated into the *chapeau* of the recommendation. It was further suggested that a distinction should be made between criteria used to evaluate the soundness of the financing proposed for each phase of the project (i.e. construction and operation). Lastly, it was proposed that subparagraph *(f)* should be deleted because it would not be appropriate to evaluate proposals in terms of their responsiveness to the contractual terms proposed by the contracting authority. It would be preferable to incorporate the notion of responsiveness in the *chapeau* of recommendation 23, and possibly in the *chapeau* of recommendation 22 as well, by inserting words such as "[I]n conformity with the proposed contractual terms".

249. The Commission heard expressions of strong support for those proposals, in particular to the deletion of subparagraph *(f)*, since in some legal systems the acceptance of the contractual terms circulated with the request for proposals was a mandatory requirement. The prevailing view, however, was that the current text of the recommendation should be retained. It was sufficiently clear that the items listed in subparagraphs *(a)-(e)* were intended to apply, as appropriate, in the evaluation of the soundness of financial proposals in respect of the various phases of the project. As regards subparagraph *(f)*, it was generally felt that the provision was useful and should not be deleted. The complexity of privately financed infrastructure projects made it unlikely that the contracting authority and the selected bidder could agree on the terms of a draft project agreement without negotiations and adjustments to adapt those terms to the particular needs of the project. It was therefore appropriate to include an assessment of the responsiveness of bidders to the proposed contractual terms among the criteria for the evaluation of the financial and commercial proposals.

250. After deliberation, the Commission adopted recommendation 23.

Recommendation 24

251. The text of the draft recommendation was as follows:

"The contracting authority may establish thresholds with respect to quality, technical and commercial aspects to be reflected in the proposals in accordance with the criteria set out in the request for proposals. Proposals that fail to achieve the thresholds should be regarded as non-responsive."

252. Subject to inserting the word "financial" before the words "and commercial" in the first sentence, the Commission adopted recommendation 24.

Recommendation 25

253. The text of the draft recommendation was as follows:

"Whether or not it has followed a pre-selection process, the contracting authority may retain the right to require the bidders to demonstrate their qualifications again in accordance with criteria and procedures set forth

in the request for proposals or the pre-selection documents, as appropriate. Where a pre-selection process has been followed, the criteria shall be the same as those used in the pre-selection process."

254. The Commission adopted recommendation 25.

Recommendation 26

255. The text of the draft recommendation was as follows:

"The contracting authority should rank all responsive proposals on the basis of the evaluation criteria set forth in the request for proposals and invite for final negotiation of the project agreement the bidder that has attained the best rating. Final negotiations may not concern those terms of the contract which were stated as non-negotiable in the final request for proposals."

256. The question was raised as to how the contracting authority should proceed if, after evaluation of the proposals, two or more proposals obtained the highest rating or if there was only an insignificant difference in the rating of two or more proposals. In response, it was stated that under such circumstances it would be appropriate for the contracting authority to invite for negotiations all the bidders that had obtained essentially the same rating. It was generally felt, however, that an appropriate comment to that effect should be included in the relevant notes, rather than in the recommendation.

257. The suggestion was made that the recommendation should include advice as to how contracting authorities should handle requests by prospective lenders for changes in the proposed contractual arrangements. In response, it was stated that the issue, although of great concern in practice, was not necessarily a matter for legislative action and had already been adequately dealt with in paragraphs 56, 70 and 82 of the notes to chapter III (A/CN.9/471/Add.4).

258. After deliberation, the Commission adopted recommendation 26.

Recommendation 27

259. The text of the draft recommendation was as follows:

"If it becomes apparent to the contracting authority that the negotiations with the bidder invited will not result in a project agreement, the contracting authority should inform that bidder that it is terminating the negotiations and then invite for negotiations the other bidders on the basis of their ranking until it arrives at a project agreement or rejects all remaining proposals."

260. The Commission adopted recommendation 27.

Direct negotiations

Recommendation 28

261. The text of the draft recommendation was as follows:

"The law should set forth the exceptional circumstances under which the contracting authority may be authorized by a higher authority to select the concessionaire through direct negotiations, such as:

"*(a)* When there is an urgent need for ensuring continuity in the provision of the service and engaging in a competitive selection procedure would therefore be impractical;

"*(b)* In case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount;

"*(c)* Reasons of national defence or national security;

"*(d)* Cases where there is only one source capable of providing the required service (for example, because it requires the use of patented technology or unique know-how);

"*(e)* When an invitation to the pre-selection proceedings or a request for proposals has been issued but no applications or proposals were submitted or all proposals failed to meet the evaluation criteria set forth in the request for proposals and if, in the judgement of the contracting authority, issuing a new request for proposals would be unlikely to result in a project award;

"*(f)* Other cases where the higher authority authorizes such an exception for compelling reasons of public interest."

262. By way of a general comment, it was stated that the expression "direct negotiations", which appeared in recommendations 28 and 29, as well as in the corresponding notes, although adopted by the Commission at its thirty-second session,[4] did not adequately reflect the nature of the procedures described in those recommendations. It was pointed out that recommendations 28 and 29 contemplated the use, under exceptional circumstances, of a procedure different from those described in recommendations 14-27. That difference consisted essentially of the absence of a structured competition among bidders, as was otherwise called for under recommendations 14-27. Negotiations with bidders, however, were not exclusive to recommendations 28 and 29, since a certain degree of negotiation was already provided at various stages of the selection procedure under recommendations 14-27, in particular under recommendations 26 and 27.

263. After deliberation, the Commission decided that the phrase "concession award without competitive procedures" should be used instead of the words "direct negotiations" in the title of section D of chapter III (see A/CN.9/471/Add.4) and that the *chapeau* of recommendation 28 should be amended to read:

"The law should set forth the exceptional circumstances under which the contracting authority may be authorized to award a concession without using competitive procedures, such as:"

264. The Commission noted that, as a result of the adoption of the new wording, a series of consequential amend-

[4] Ibid., paras. 127 and 128.

ments might be required in the relevant notes in chapter III (see A/CN.9/471/Add.4) and possibly in other legislative recommendations and parts of the draft legislative guide. The Commission requested the secretariat to ensure that the necessary changes were made.

265. The Commission agreed that recommendation 28 should also refer to unsolicited proposals, which under certain circumstances might justify the award of a concession without competitive procedures (see paras. 277 and 279).

Recommendation 29

266. The text of the draft recommendation was as follows:

"The law may require that the following procedures be observed in direct negotiations:

"*(a)* The contracting authority should publish a notice of the negotiation proceedings and engage in negotiations with as many companies judged capable of carrying out the project as circumstances permit;

"*(b)* The contracting authority should establish and make known to bidders the qualification criteria and the criteria for evaluating the proposals and should determine the relative weight to be accorded to each such criterion and the manner in which criteria are to be applied in the evaluation of the proposals;

"*(c)* The contracting authority should treat proposals in a manner that avoids the disclosure of their contents to competing bidders;

"*(d)* Any such negotiations between the contracting authority and bidders should be confidential and one party to the negotiations should not reveal to any other person any technical, price or other commercial information relating to the negotiations without the consent of the other party;

"*(e)* Following completion of negotiations, the contracting authority should request all bidders remaining in the proceedings to submit, by a specified date, a best and final offer with respect to all aspects of their proposals;

"*(f)* Proposals should be evaluated and ranked according to the criteria for the evaluation of proposals established by the contracting authority."

267. The view was expressed that recommendation 29 was unnecessarily detailed on procedural matters of limited practical relevance, since a contracting authority faced with the exceptional circumstances referred to in recommendation 28 might often have no choice but to negotiate with only one company. For the conceivably rare cases where the contracting authority had more choices, it would be sufficient if the notes referred to measures to introduce competitiveness into such negotiations, such as those referred to in subparagraphs *(b)*, *(c)* and *(e)*, which, however, in their current form, were not needed. More important than those provisions was the disclosure of the reasons for awarding a concession without competitive procedures, a requirement that should be expressly made in recommendation 29. As for subparagraph *(d)*, which was said to be relevant for the final negotiations under recommendations 26 and 27 as well, it was proposed that it should become a separate recommendation and be placed before recommendation 36.

268. Strong support was expressed for those proposals, which were generally felt to enhance transparency in the award of concessions without the use of competitive procedures. It was pointed out, however, that the requirement of publicity concerning the reasons for awarding a concession without competitive procedures should be weighted against other reasons of public interest, in particular the need for confidentiality of decisions on matters of national defence or security.

269. After deliberation, the Commission agreed that recommendation 29 should be redrafted along the following lines:

"The law may require that the following procedures be observed for the award of a concession without competitive procedures:

"*(a)* The contracting authority should publish a notice of its intention to award a concession for the implementation of the proposed project and should engage in negotiations with as many companies judged capable of carrying out the project as circumstances permit;

"*(b)* Offers should be evaluated and ranked according to the criteria for the evaluation of proposals established by the contracting authority;

"*(c)* Except for the situation referred to in recommendation 28 *(c)*, the contracting authority should cause a public notice of the concession award to be published, disclosing the specific circumstances and reasons for the award of the concession without competitive procedures."

270. The Commission noted that, as a result of the adoption of the new text for recommendation 29, a series of consequential amendments might be required in the relevant notes in chapter III (A/CN.9/471/Add.4) and possibly in other legislative recommendations and parts of the draft legislative guide. The Commission requested the secretariat to ensure that the necessary changes were made.

Unsolicited proposals

Recommendation 30

271. The text of the draft recommendation was as follows:

"By way of exception to the selection procedures described in legislative recommendations 14-27, the contracting authority may be authorized to handle unsolicited proposals pursuant to specific procedures established by the law for handling unsolicited proposals, provided that such proposals do not relate to a project for which selection procedures have been initiated or announced by the contracting authority."

272. The Commission adopted recommendation 30.

Recommendation 31

273. The text of the draft recommendation was as follows:

"Following receipt and preliminary examination of an unsolicited proposal, the contracting authority should inform the proponent, within a reasonably short period, whether or not there is a potential public interest in the project. If the project is found to be in the public interest, the contracting authority should invite the proponent to submit a formal proposal in sufficient detail to allow the contracting authority to make a proper evaluation of the concept or technology and determine whether the proposal meets the conditions set forth in the law and is likely to be successfully implemented on the scale of the proposed project."

274. The Commission adopted recommendation 31.

Recommendation 32

275. The text of the draft recommendation was as follows:

"The proponent should retain title to all documents submitted throughout the procedure and those documents should be returned to it in the event the proposal is rejected."

276. The Commission adopted recommendation 32.

Recommendation 33

277. The text of the draft recommendation was as follows:

"The contracting authority should initiate competitive selection procedures under recommendations 14-27 above if it is found that the envisaged output of the project can be achieved without the use of a process, design, methodology or engineering concept for which the author of the unsolicited proposal possesses exclusive rights or if the proposed concept or technology is not truly unique or new. The author of the unsolicited proposal should be invited to participate in such proceedings and might be given a premium for submitting the proposal."

278. The Commission adopted recommendation 33.

Recommendation 34

279. The text of the draft recommendation was as follows:

"If it appears that the envisaged output of the project cannot be achieved without using a process, design, methodology or engineering concept for which the author of the unsolicited proposal possesses exclusive rights, the contracting authority should seek to obtain elements of comparison for the unsolicited proposal. For that purpose, the contracting authority should publish a description of the essential output elements of the proposal with an invitation for other interested parties to submit alternative or comparable proposals within a certain reasonable period."

280. The Commission adopted recommendation 34.

Recommendation 35

281. The text of the draft recommendation was as follows:

"The contracting authority may engage in negotiations with the author of the unsolicited proposal if no alternative proposals are received, subject to approval by a higher authority. If alternative proposals are submitted, the contracting authority should invite all the proponents to negotiations in accordance with the provisions of legislative recommendation 29 *(b)-(f)*."

282. The Commission adopted recommendation 35 (but see paras. 269 and 270).

Review procedures

Recommendation 36

283. The text of the draft recommendation was as follows:

"Bidders who claim to have suffered, or who may suffer, loss or injury owing to a breach of a duty imposed on the contracting authority by the law may seek review of the contracting authority's acts in accordance with the laws of the host country."

284. The Commission agreed that recommendation 36 should be the final recommendation on the selection of the concessionaire and that its accompanying notes should be moved to the end of chapter III (A/CN.9/471/Add.4). Subject to those changes, the Commission adopted recommendation 36.

Notice of project award

Recommendation 37

285. The text of the draft recommendation was as follows:

"The contracting authority should cause a notice of the award of the project to be published. The notice should identify the concessionaire and include a summary of the essential terms of the project agreement."

286. The Commission adopted recommendation 37.

Record of selection and award proceedings

Recommendation 38

287. The text of the draft recommendation was as follows:

"The contracting authority should keep an appropriate record of key information pertaining to the selection and award proceedings. The law should set forth the requirements for public access."

288. Subject to restoring the second sentence of the recommendation in the French version, where it did not appear, the Commission adopted recommendation 38.

CHAPTER IV. CONSTRUCTION AND OPERATION OF INFRASTRUCTURE

289. The Commission requested the secretariat to revise the title of the chapter so as to reflect more clearly the issues discussed therein, which were largely concerned with the contents of the project agreement and its relation to the construction and operation of infrastructure. Subsequently the secretariat proposed the following title, which was approved by the Commission: "Construction and operation: legislative framework and project agreement".

General provisions on the project agreement

Recommendation 39

290. The text of the draft recommendation was as follows:

> "The law might identify the core terms to be provided in the project agreement, which may include those terms referred to in recommendations 39-65 below."

291. Subject to changing the cross-reference to legislative recommendations 40-67, the Commission adopted recommendation 39.

Recommendation 40

292. The text of the draft recommendation was as follows:

> "Unless otherwise provided, the project agreement is governed by the law of the host country."

293. In response to a question as to the meaning of the opening phrase of the recommendation, it was pointed out that the issue of the law governing the project agreement had been the subject of extensive debate at the thirty-second session of the Commission. The flexible wording eventually agreed upon by the Commission was intended to take into account the fact that, under some legal systems, provisions allowing for the application of a law other than the law of the host country could only be of a statutory nature, whereas in other legal systems the contracting authority might have the power to agree on the applicable law. The Commission adopted recommendation 40.

Organization of the concessionaire

Recommendation 41

294. The text of the draft recommendation was as follows:

> "The contracting authority should have the option to require that the selected bidders establish an independent legal entity with a seat in the country."

295. The Commission adopted recommendation 41.

Recommendation 42

296. The text of the draft recommendation was as follows:

> "The project agreement should specify the minimum capital of the project company and the procedures for obtaining the approval of the contracting authority to its statutes and by-laws of the project company and fundamental changes therein."

297. The Commission adopted recommendation 42.

The project site and easements

Recommendation 43

298. The text of the draft recommendation was as follows:

> "The project agreement should specify, as appropriate, which assets will be public property and which assets will be the private property of the concessionaire. The project agreement should identify which assets the concessionaire is required to transfer to the contracting authority or to a new concessionaire upon expiry or termination of the project agreement; which assets the contracting authority, at its option, may purchase from the concessionaire; and which assets the concessionaire may freely remove or dispose of upon expiry or termination of the project agreement."

299. The Commission adopted recommendation 43, subject to amending the heading to read "project site, assets and easements".

Recommendation 44

300. The text of the draft recommendation was as follows:

> "The contracting authority should assist the concessionaire in the acquisition of easements needed for the operation, construction and maintenance of the facility. The law might empower the concessionaire to enter upon, transit through, do work or fix installations upon property of third parties, as required for the construction and operation of the facility."

301. The view was expressed that the reference in the first sentence of the recommendation to assistance by the contracting authority in connection with the acquisition of easements was unclear and possibly in conflict with the second sentence of the recommendation. It was proposed that the first sentence of the recommendation be expanded to reflect the idea that the contracting authority should assist in securing the land and other property required by the concessionaire to carry out the project. The Commission heard expressions of strong support for that proposal. It was pointed out that, in practice, considerable problems in the implementation of infrastructure projects might be caused by delay in acquiring the land for the project site. That problem, it was pointed out, had been identified in paragraphs 20-22 of chapter IV, "Construction and opera-

tion of infrastructure" (see A/CN.9/471/Add.5), but no legislative recommendation reflected the discussion in those notes. The legislative guide, it was stated, had an important role to play in reminding contracting authorities, by a legislative recommendation, of their responsibility for providing the concessionaire with the assistance required to secure an appropriate site for the project.

302. The countervailing view, which also met with strong support, was that issues related to acquisition and ownership of land were foreign to recommendation 44, which was only concerned with easements that might be needed by the concessionaire in connection with the construction, operation or maintenance of the infrastructure facility. The perceived lack of clarity of the sentence was attributable to the use of the phrase "acquisition of easements", which was said to create difficulties of interpretation in some legal systems. If the Commission felt that the first sentence of the recommendation was unclear, it would be preferable to delete the sentence rather than to expand it as had been proposed.

303. The Commission considered various proposals made to address the concerns that had been expressed. It was pointed out that, in paragraphs 30-32 of chapter IV, "Construction and operation of infrastructure" (see A/CN.9/471/Add.5), two alternative ways were identified for the concessionaire to obtain the easements it required: either by appropriate arrangements between the concessionaire and the owners of the property concerned or by legislation that empowered the concessionaire to enter, pass through or do work or fix installations upon the property of third parties. It was thus proposed that the connection between the two sentences of the recommendation be clarified by adding words such as "[A]nother solution might be for the law to empower" at the beginning of the second sentence. In response, it was stated that the proposal might indeed be useful to clarify the way in which the legislative recommendation reflected the discussion of legal problems related to easements in the notes. However, by dealing only with easements, the proposal did not provide an adequate answer to questions related to the project site itself, which had been identified in the notes to the legislative recommendations.

304. After consideration of the different views and proposals heard by the Commission, the prevailing view was that the first sentence of the legislative recommendation should be redrafted to read: "The contracting authority should assist the concessionaire in obtaining such rights related to the project site as necessary for the operation, construction and maintenance of the facility." Subject to that amendment and to the addition of the word "maintenance" in the second sentence, the Commission adopted recommendation 44. The Commission requested the secretariat to make the necessary adjustments to the notes in order to align them with the new text of the recommendation. It was generally understood that the recommendation did not affect the property regime in the host country.

Financial arrangements

Recommendation 45

305. The text of the draft recommendation was as follows:

"The law should enable the concessionaire to collect tariffs or user fees for the use of the facility or the services it provides. The project agreement should provide for methods and formulas for the adjustment of those tariffs or user fees."

306. The Commission adopted recommendation 45.

Recommendation 46

307. The text of the draft recommendation was as follows:

"Where the tariffs or fees charged by the concessionaire are subject to external control by a regulatory body, the law should set forth the mechanisms for periodic and extraordinary revisions of the tariff adjustment formulas."

308. The Commission adopted recommendation 46.

Recommendation 47

309. The text of the draft recommendation was as follows:

"The contracting authority should have the power, where appropriate, to agree to make direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users or to enter into commitments for the purchase of fixed quantities of goods or services."

310. The Commission adopted recommendation 47.

Security interests

Recommendation 48

311. The text of the draft recommendation was as follows:

"The concessionaire should be responsible for raising the funds required to construct and operate the infrastructure facility and, for that purpose, should have the right to secure any financing required for the project with a security interest in any of its property, with a pledge of shares of the project company, with a pledge of the proceeds and receivables arising out of the concession or with other suitable security, without prejudice to any rule of law that might prohibit the creation of security interests in public property in the possession of the concessionaire."

312. Subject to the deletion of the words "in the possession of the concessionaire", the Commission adopted recommendation 48.

Assignment of the concession

Recommendation 49

313. The text of the draft recommendation was as follows:

"The project agreement should set forth the conditions under which the contracting authority might give its con-

sent to an assignment of the concession, including the acceptance by the new concessionaire of all obligations under the project agreement and evidence of the new concessionaire's technical and financial capability as necessary for providing the service. The concession should not be assigned to third parties without the consent of the contracting authority."

314. The view was expressed that the second sentence of the recommendation was overly restrictive and might hinder the contracting authority's ability to enter into a direct agreement with lenders for the substitution of the concessionaire by another entity selected in agreement with the lenders in case of default by the concessionaire. In response, it was pointed out that infrastructure concessions, as generally understood by the Commission, were awarded in the light of the concessionaire's technical and financial capabilities and, as such, were not freely transferable, a principle that was reflected in the second sentence. The possibility given to lenders to appoint a substitute concessionaire, in agreement with the contracting authority (a situation covered by the first sentence of the recommendation), constituted an exception accepted by the Commission to the general rule stated in the second sentence.

315. Subject to reversing the order of the two sentences, in order to clarify the way they related to one another, the Commission adopted recommendation 49.

Transfer of controlling interest in the project company

Recommendation 50

316. The text of the draft recommendation was as follows:

"The transfer of a controlling interest in the capital of a concessionaire company may require the consent of the contracting authority."

317. The view was expressed that the recommendation was overly restrictive, since there were circumstances where restrictions on the transfer of a controlling interest in a concessionaire company might not be reasonable. In response, it was noted that recommendation 50 shared the same rationale as recommendation 49. Nevertheless, with a view to making it clear that there might be exceptions to such a rule, it was agreed that words such as "unless otherwise provided" should be added at the end of the recommendation.

318. Subject to that amendment and the deletion of the words "the capital of", which were deemed unnecessary, the Commission adopted recommendation 50.

Construction works

Recommendation 51

319. The text of the draft recommendation was as follows:

"The project agreement should set forth the procedures for the review and approval of construction plans and specifications by the contracting authority, the contracting authority's right to monitor the construction of, or improvements to, the infrastructure facility, the conditions under which the contracting authority may order variations in respect of construction specifications and the procedures for testing and final inspection, approval and acceptance of the facility, its equipment and appurtenances."

320. The Commission adopted recommendation 51.

Operation of infrastructure

Recommendation 52

321. The text of the draft recommendation was as follows:

"The project agreement should set forth, as appropriate, the extent of the concessionaire's obligations to ensure:

"*(a)* The adaptation of the service so as to meet the actual demand for the service;

"*(b)* The continuity of the service;

"*(c)* The availability of the service under essentially the same conditions to all users;

"*(d)* The non-discriminatory access, as appropriate, of other service providers to any public infrastructure network operated by the concessionaire."

322. It was suggested that the words "evolution of demand" should be substituted for the words "actual demand" in subparagraph *(a)*, so as to express more clearly the idea that the concessionaire was under an obligation to ensure the adaptation of the service to both quantitative and qualitative changes of demand. It was also suggested that subparagraph *(c)* should refer to the concessionaire's obligation to "ensure equal access" of users to the service. Lastly, it was suggested that subparagraph *(d)* should refer to the need to ensure interconnection between infrastructure networks under objective, transparent and non-discriminatory conditions.

323. Noting that the issues discussed in the recommendation had been extensively debated at its previous sessions, the Commission adopted recommendation 52 without the proposed amendments.[5]

Recommendation 53

324. The text of the draft recommendation was as follows:

"The project agreement should set forth:

"*(a)* The extent of the concessionaire's obligation to provide the contracting authority or a regulatory body, as appropriate, with reports and other information on its operations;

[5]Ibid., *Fifty-third Session, Supplement No. 17* (A/53/17), paras. 96-114, and ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), paras. 185-187.

"*(b)* The procedures for monitoring the concessionaire's performance and for taking such reasonable actions as the contracting authority or a regulatory body may find appropriate, to ensure that the infrastructure facility is properly operated and the services are provided in accordance with the applicable legal and contractual requirements."

325. The Commission adopted recommendation 53.

Recommendation 54

326. The text of the draft recommendation was as follows:

"The concessionaire should have the right to issue and enforce rules governing the use of this facility, subject to the approval of the contracting authority or a regulatory body."

327. The Commission adopted recommendation 54.

General contractual arrangements

Recommendation 55

328. The text of the draft recommendation was as follows:

"The contracting authority may reserve the right to review and approve major contracts to be entered into by the concessionaire, in particular contracts with the concessionaire's own shareholders or related persons. The contracting authority's approval should not normally be withheld except where the contracts contain provisions inconsistent with the project agreement or manifestly contrary to the public interest or to mandatory rules of a public law nature."

329. The Commission adopted recommendation 55.

Recommendation 56

330. The text of the draft recommendation was as follows:

"The concessionaire and its lenders, insurers and other contracting partners should be free to choose the law applicable to govern their contractual relations, except where such a choice would violate the host country's public policy."

331. The Commission adopted recommendation 56.

Recommendation 57

332. The text of the draft recommendation was as follows:

"The project agreement should set forth:

"*(a)* The forms, duration and amounts of the guarantees of performance that the concessionaire may be required to provide in connection with the construction and the operation of the facility;

"*(b)* The insurance policies that the concessionaire may be required to maintain;

"*(c)* The compensation to which the concessionaire may be entitled following the occurrence of legislative changes or other changes in the economic or financial conditions that render the performance of the obligation substantially more onerous than originally foreseen. The project agreement should further provide mechanisms for revising the terms of the project agreement following the occurrence of any such changes;

"*(d)* The extent to which either party may be exempt from liability for failure or delay in complying with any obligation under the project agreement owing to circumstances beyond their reasonable control;

"*(e)* Remedies available to the contracting authority and the concessionaire in the event of default by the other party."

333. The Commission adopted recommendation 57.

Recommendation 58

334. The text of the draft recommendation was as follows:

"The project agreement should set forth the circumstances under which the contracting authority may temporarily take over the operation of the facility for the purpose of ensuring the effective and uninterrupted delivery of the service in the event of serious failure by the concessionaire to perform its obligations."

335. The Commission adopted recommendation 58.

Recommendation 59

336. The text of the draft recommendation was as follows:

"The contracting authority should be authorized to enter into agreements with the lenders providing for the appointment, with the consent of the contracting authority, of a new concessionaire to perform under the existing project agreement if the concessionaire seriously fails to deliver the service required or if other specified events occur that could justify the termination of the project agreement."

337. The Commission adopted recommendation 59.

CHAPTER V. DURATION, EXTENSION AND TERMINATION OF THE PROJECT AGREEMENT

Duration and extension of the project agreement

Recommendation 60

338. The text of the draft recommendation was as follows:

"The duration of the concession should be specified in the project agreement."

339. The Commission adopted recommendation 60.

Recommendation 61

340. The text of the draft recommendation was as follows:

"The term of the concession should not be extended, except under those circumstances specified in the law, such as:

"*(a)* Completion delay or interruption of operation due to the occurrence of circumstances beyond either party's reasonable control;

"*(b)* Project suspension brought about by acts of the contracting authority or other public authorities;

"*(c)* To allow the concessionaire to recover additional costs arising from requirements of the contracting authority not originally foreseen in the project agreement that the concessionaire would not be able to recover during the normal term of the project agreement."

341. A suggestion was made to replace in subparagraph *(a)* the concept of "circumstances beyond either party's reasonable control" by the expression "force majeure" (and to use the equivalent expression in the other language versions). This was suggested because the proposed term was widely known and understood in the context of various national laws. The Commission preferred to retain the current text, however, because it used an expression that conveyed the intended meaning but was less likely to be subject to possible different interpretations and meanings in national legal systems than the term "force majeure". It was noted that the current wording had been modelled on article 79 of the United Nations Sales Convention, which had also been used as a model in other international texts such as the UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works (chap. XXI, "Exemption clauses", para. 6). In order not to depart from those models, the Commission also did not accept the suggestion to delete the word "reasonable" from subparagraph *(a)*.

342. The Commission adopted recommendation 61.

Termination of the project agreement

Recommendation 62

343. The text of the draft recommendation was as follows:

"The contracting authority should have the right to terminate the project agreement:

"*(a)* In the event that it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations, owing to insolvency, serious breach or otherwise;

"*(b)* For reasons of public interest, subject to payment of compensation to the concessionaire."

344. A proposal was made to replace in subparagraph *(a)* the words "it can no longer be reasonably expected that the concessionaire will be able" with the words "the concessionaire is unable". The proposal was not adopted because the suggested words would have implied that termination would be available only after it was established that the concessionaire was unable to perform its obligations. The policy underlying the subparagraph, in turn, was to allow termination already when it was reasonably certain that the concessionaire would be unable to perform its obligations. It was important to maintain the current wording in order to allow the contracting authority to terminate the concession soon enough to be able to find an alternative way of providing the public service.

345. The Commission adopted recommendation 62.

Recommendation 63

346. The text of the draft recommendation was as follows:

"The concessionaire should have the right to terminate the project agreement under exceptional circumstances specified in the law, such as:

"*(a)* In the event of serious breach by the contracting authority or other public authority as regards the fulfilment of their obligations under the project agreement;

"*(b)* In the event that the concessionaire's performance is rendered substantially more onerous as a result of variation orders or other acts of the contracting authority, unforeseen changes in conditions or acts of other public authorities and that the parties have failed to agree on an appropriate revision of the project agreement."

347. It was suggested that the recommendation should be reformulated so as to reflect the idea that, at least in some legal systems, the concessionaire's right to terminate the project agreement was based on grounds that were different from and were more restricted than the contracting authority's right to terminate the concession. The Commission did not accept the suggestion because it considered that the extent of the right of the concessionaire to terminate the project agreement (as compared to such a right of the contracting authority) was appropriately explained in the notes on the legislative recommendation (A/CN.9/471/Add.6, para. 28).

348. The Commission adopted recommendation 63.

Recommendation 64

349. The text of the draft recommendation was as follows:

"Either party should have the right to terminate the project agreement in the event that the performance of its obligations is rendered impossible by the occurrence of circumstances beyond either party's reasonable control. The parties should also have the right to terminate the project agreement by mutual consent."

350. The Commission adopted recommendation 64.

Consequences of expiry or termination of the project agreement

Recommendation 65

351. The text of the draft recommendation was as follows:

"The project agreement should lay down the criteria for establishing, as appropriate, the compensation to which the concessionaire may be entitled in respect of assets transferred to the contracting authority or to a new concessionaire or purchased by the contracting authority upon expiry or termination of the project agreement."

352. The Commission adopted recommendation 65.

Recommendation 66

353. The text of the draft recommendation was as follows:

"The project agreement should stipulate how compensation due to either party in the event of termination of the project agreement is to be calculated, providing, where appropriate, for compensation for the fair value of works performed under the project agreement and for losses, including lost profits."

354. The Commission adopted recommendation 66.

Recommendation 67

355. The text of the draft recommendation was as follows:

"The project agreement should set out, as appropriate, the rights and obligations of the parties with respect to:

"*(a)* The transfer of technology required for the operation of the facility;

"*(b)* The training of the contracting authority's personnel or of a successor concessionaire in the operation and maintenance of the facility;

"*(c)* The provision, by the concessionaire, of operation and maintenance services and the supply of spare parts, if required, for a reasonable period after the transfer of the facility to the contracting authority or to a successor concessionaire."

356. The Commission adopted recommendation 67.

CHAPTER VI. SETTLEMENT OF DISPUTES

Disputes between the contracting authority and the concessionaire

Recommendation 68

357. The text of the draft recommendation was as follows:

"The contracting authority should be free to agree to dispute settlement mechanisms regarded by the parties as suited to the needs of the project, including arbitration."

358. The suggestion was made to delete the words "including arbitration", as arbitration was one of the methods of settling disputes and it should not be singled out in the recommendation to the exclusion of others. Considerable support was expressed for that suggestion and reasoning. However, there was also wide support for retaining the words in the recommendation, since arbitration, which was crucial for the settlement of international disputes, was the only binding non-judicial method that was typically required by investors in international privately financed infrastructure projects. The recommendation was also deemed necessary in view of the fact that a number of countries were modifying their laws to allow contracting authorities to use arbitration in privately financed infrastructure projects. A further suggestion was to clarify that the freedom to agree to arbitrate included the freedom to agree to arbitration in a country other than the host country.

359. After weighing the various arguments and wishing to present a balanced text reflecting the differing views and also taking into consideration the explanations given in the notes (A/CN.9/471/Add.7, paras. 30-38), the Commission decided to delete the words "including arbitration". However, in order to reflect the importance of arbitration in international privately financed infrastructure projects, it decided to reformulate the third sentence of paragraph 30 of the notes to the effect that "[A]rbitration, often in a country other than the host country, was preferred and in many cases required by private investors and lenders". The Commission also reformulated the expression in the recommendation "regarded by the parties as suited" to read "regarded by the parties as best suited".

360. The Commission decided to add in paragraph 27 of the notes (A/CN.9/471/Add.7) the words "or arbitrate" after the words "to accept the recommendations voluntarily rather than litigate" and to add the words "or arbitration" after the words "[A]part from avoiding potentially protracted litigation".

361. Subject to those modifications, the Commission adopted recommendation 68.

*Recommendation 68*bis

362. The text of the draft recommendation was as follows:

"[The law should indicate whether and, if so, to what extent the contracting authority may raise a plea of sovereign immunity, both as a bar to the commencement of arbitral or judicial proceedings and as a defence against enforcement of the award or judgement.]"

363. Wide support was expressed for the deletion of the recommendation. It was noted that the recommendation raised controversial issues that had not yet been settled in international law; that the recommendation did not and could not deal with the issue of whether sovereign immunity was a matter requiring general treatment in legislation

or was to be left to the discretion of the executive branch of the Government; and that sovereign immunity was currently expected to be considered by the Sixth Committee of the General Assembly and the outcome of that consideration was not yet known. Objections were also raised with regard to the proposal on the ground that the recommendation and the accompanying notes did not call for a unified or harmonized legislative approach to the matter and did not suggest any particular solution to be adopted. The recommendation was merely calling upon States to clarify whether and, if so, to what extent the contracting authority might raise a plea of sovereign immunity. Nevertheless, the prevailing view was that recommendation 68*bis* should be deleted.

364. The Commission turned its attention to the notes accompanying the recommendation and accepted the suggestion to replace in paragraph 36 the words "may not plead sovereign immunity" with the words "may or may not plead sovereign immunity" and to transpose the amended paragraph 36 to precede paragraph 33. The Commission did not accept a suggestion to delete the last sentence of paragraph 33.

Disputes between the concessionaire and its lenders, contractors and suppliers

Recommendation 69

365. The text of the draft recommendation was as follows:

> "The concessionaire should be free to choose the appropriate mechanisms for settling commercial disputes among the project promoters, or disputes between the concessionaire and its lenders, contractors, suppliers and other business partners."

366. The Commission adopted recommendation 69 subject to the addition of the words "and the project promoters" before the words "should be free".

Disputes between the concessionaire and its customers

Recommendation 70

367. The text of the draft recommendation was as follows:

> "The concessionaire may be required to make available simplified and efficient mechanisms for handling claims submitted by its customers or users of the infrastructure facility."

368. The Commission adopted recommendation 70. As regards the accompanying notes (A/CN.9/471/Add.7, para. 43, in particular the second and third sentences), it was observed that, while lenders frequently preferred that arbitration be used for solving disputes arising out of the project agreement and increasingly also for disputes between different lenders, judicial proceedings were often the preferred method for disputes arising out of loan agreements between the lenders and the concessionaire. The Commission requested the secretariat to reformulate the paragraph to reflect that circumstance.

C. Finalization of the legislative guide

369. The Commission heard expressions of strong support for proposals for rearranging the chapters of the legislative guide, in particular a proposal to combine chapter VII, "Other relevant areas of law" (A/CN.9/471/Add.8), with chapter I, "General legislative and institutional framework" (A/CN.9/471/Add.2). Nevertheless, the Commission decided to retain the current structure of the guide.

370. The Commission decided that all legislative recommendations should appear together before the notes thereto, rather than at the beginning of the chapters to which each block of recommendations pertained.

371. The Commission requested the secretariat to review and revise, as appropriate, the text of the notes to the legislative recommendations in order to ensure consistency with the recommendations, as adopted by the Commission, as well as terminological accuracy and consistency in the various language versions. The Commission invited its members and observers participating at the current session to submit their linguistic observations or suggestions directly to the secretariat.

D. Adoption of the legislative guide

372. At its 703rd meeting, on 29 June 2000, the Commission adopted the *Legislative Guide*, consisting of the legislative recommendations (A/CN.9/471/Add.9), with the amendments adopted by the Commission at the current session (see paras. 195-368 above) and the notes to the legislative recommendations (A/CN.9/471/Add.1-8), which the secretariat was authorized to finalize in the light of the deliberations of the Commission. The Commission mandated the publication of the *Guide* under the title "UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects" and requested the secretariat to transmit the text of the *Guide* to Governments and other interested bodies. The Commission also recommended that all States give favourable consideration to the *Legislative Guide* when revising or adopting legislation relevant to privately financed infrastructure projects. It furthermore requested the secretariat to ensure the widest possible dissemination of the *Guide*.

373. Upon the adoption of the Legislative Guide, the Commission heard a statement by the representative of the Economic Commission for Europe (ECE), who congratulated the Commission on the completion of the *Guide*, which was expected to become a useful instrument for domestic legislators and policy makers. While domestic policies for infrastructure in the early 1990s had given preference to ad hoc contractual solutions, there was growing awareness of the importance of an adequate legislative and regulatory framework for privately financed infrastructure projects. ECE had developed considerable expertise in various areas related to those projects, in particular economic, financial and contractual aspects, and was preparing guidelines to assist domestic public authorities in negotiating project agreements. ECE stood ready to assist the secretariat of the Commission in disseminating the *Legislative Guide* and to cooperate in other areas of common interest.

374. The Commission took note with appreciation of the statement of the representative of ECE and expressed its gratitude to ECE for its interest in cooperating with the UNCITRAL secretariat.

E. Possible future work in the area of privately financed infrastructure projects

375. The view was expressed that the *Legislative Guide*, as it stood, would be a useful reference for domestic legislators in establishing a legal framework favourable to private investment in public infrastructure. Nevertheless, it would be desirable for the Commission to formulate more concrete guidance in the form of model legislative provisions or even in the form of a model law dealing with specific issues. Such a proposal had been made at the early stages of the preparation of the *Legislative Guide* and had since been reiterated on various occasions. The preference that the Commission had expressed for the preparation of a *Legislative Guide* had been mainly attributable to a lack of consensus as to which of the various issues dealt with in the Guide might be suitable subjects of model legislative provisions. However, in the course of that work, a clearer understanding had developed within the Commission with regard to the issues involved and the options available. The legislative recommendations adopted by the Commission at the current session reflected that common understanding and represented a good starting point for future work aimed at providing more concrete guidance, for which there was a pressing need, in particular in countries with economies in transition and in developing countries.

376. Strong support was expressed for the above proposals. It was stated that concrete legislative guidance in the form of a model law or model legislative provisions would be especially useful for legislators and policy makers in countries that lacked the expertise or the human resources to analyse in depth the various issues discussed in the *Legislative Guide*. It was also said that, in its current form, the *Guide* was rather lengthy and some of the legislative recommendations were not easy to translate into legislative language. As to the appropriate time for starting such future work, views differed as to whether the Commission should take a decision at its current session or should await the completion of other ongoing projects.

377. Strong objections were voiced to the above proposals. As a matter of principle, the proposals were objected to in the light of the potential difficulty and undesirability of formulating model legislative provisions on privately financed infrastructure projects in view of the diversity of national legal traditions and administrative practices. Furthermore, those projects typically raised highly complex legal issues, some of which concerned matters of public policy. The legislative recommendations had been carefully drafted by the Commission to take into account that diversity. They represented the widest possible consensus that could have been achieved on the issues dealt with. The Commission was reminded of its overall workload and of the limited resources available to its secretariat and was urged not to embark upon a potentially time-consuming exercise of doubtful feasibility.

378. Other reservations, while not questioning in principle the desirability or the feasibility of preparing a model law or model legislative provisions, were based on the need to allow the *Legislative Guide* to be first tested in practice before future work was undertaken in the same field. Concern was expressed that an immediate decision to prepare a model law or model legislative provisions might be interpreted as a sign of dissatisfaction by the Commission with the work that had just been accomplished. The Commission should give itself sufficient time to follow up on the use made of the *Legislative Guide* by domestic legislators and policy makers, to whom the Guide was addressed, so as to be in a better position to make a decision on the desirability of preparing a new instrument.

379. After consideration of the various views expressed, it was decided that the question of the desirability and feasibility of preparing a model law or model legislative provisions on selected issues covered by the *Legislative Guide* should be considered by the Commission at its thirty-fourth session, in 2001. In order to assist the Commission in making an informed decision on the matter, it was agreed that it would be desirable for the secretariat, in cooperation with other interested international organizations or international financial institutions, to organize a colloquium to disseminate knowledge about the *Legislative Guide*. The participants in the colloquium, who should include, to the extent possible, experts from the various legal traditions and economic systems represented at the Commission, should be invited to make recommendations on the desirability and, especially, the feasibility of a model law or model legislative provisions in the area of privately financed infrastructure projects for consideration by the Commission at its thirty-fourth session. Alternatively, should such a colloquium not be feasible, the secretariat was requested to seek the views of outside experts representing, to the widest extent possible, the various legal traditions and economic systems represented at the Commission on the matter and to prepare a report on the conclusions of its consultations with experts for consideration by the Commission at its thirty-fourth session.

V. ELECTRONIC COMMERCE

A. Draft uniform rules on electronic signatures

380. It was recalled that the Commission, at its thirtieth session, in 1997, had endorsed the conclusions reached by the Working Group on Electronic Commerce at its thirty-first session with respect to the desirability and feasibility of preparing uniform rules on issues of digital signatures and certification authorities and possibly on related matters (see A/CN.9/437, paras. 156 and 157). The Commission entrusted the Working Group with the preparation of uniform rules on the legal issues of digital signatures and certification authorities.[6] The Working Group began the preparation of uniform rules for electronic signatures at its thirty-second session (January 1998) on the basis of a note prepared by the secretariat (A/CN.9/WG.IV/WP.73). At its thirty-first session, in 1998, the Commission had before it the report of the Working Group (A/CN.9/446). The Com-

[6]Ibid., *Fifty-second Session, Supplement No. 17* (A/52/17), paras. 249-251.

mission 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 that had arisen from the increased use of digital and other electronic signatures. However, it was generally felt 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 it had taken at its thirtieth session as to the feasibility of preparing such uniform rules and 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.[7]

381. The Working Group continued its work at its thirty-third (July 1998) and thirty-fourth (February 1999) sessions on the basis of notes prepared by the secretariat (A/CN.9/WG.IV/WP.76, 79 and 80). At its thirty-second session, in 1999, the Commission had before it the reports of the Working Group on the work of those two sessions (A/CN.9/454 and A/CN.9/457, respectively). While the Commission generally agreed that significant progress had been made in the understanding of the legal issues of electronic signatures, it was also felt that the Working Group had been faced with difficulties in building a consensus as to the legislative policy on which the uniform rules should be based. After discussion, the Commission reaffirmed its earlier decisions as to the feasibility of preparing such uniform rules and expressed its confidence that more progress could be accomplished by the Working Group at its forthcoming sessions. While it did not set a specific time-frame for the Working Group to fulfil its mandate, the Commission urged the Group to proceed expeditiously with the completion of the draft uniform rules. An appeal was made to all delegations to renew their commitment to active participation in the building of a consensus with respect to the scope and content of the draft uniform rules.[8]

382. The Working Group continued its work at its thirty-fifth (September 1999) and thirty-sixth (February 2000) sessions on the basis of notes prepared by the secretariat (A/CN.9/WG.IV/WP. 82 and 84). At the current session, the Commission had before it the report of the Working Group on the work of those two sessions (A/CN.9/465 and 467, respectively). It was noted that the Working Group, at its thirty-sixth session, had adopted the text of articles 1 and 3-12 of the uniform rules. Some issues remained to be clarified as a result of the decision by the Working Group to delete the notion of enhanced electronic signature from the draft uniform rules. A concern was expressed that, depending on the decisions to be made by the Working Group with respect to articles 2 and 13, the remainder of the draft provisions might need to be re-examined to avoid creating a situation where the standard set by the uniform rules would apply equally to electronic signatures that ensured a high level of security and to low-value certificates that might be used in the context of electronic communications that were not intended to carry significant legal effect.

383. After discussion, the Commission expressed its appreciation for the efforts made by the Working Group and the progress achieved in the preparation of the draft uniform rules on electronic signatures. The Working Group was urged to complete its work with respect to the draft uniform rules at its thirty-seventh session and to review the draft guide to enactment to be prepared by the secretariat.

B. Future work in the field of electronic commerce

384. The Commission held a preliminary exchange of views regarding future work in the field of electronic commerce. Three topics were suggested as indicating possible areas where work by the Commission would be desirable and feasible. The first dealt with electronic contracting, considered from the perspective of the United Nations Sales Convention, which was generally felt to constitute a readily acceptable framework for on-line contracts dealing with the sale of goods. It was pointed out that, for example, additional studies might need to be undertaken to determine the extent to which uniform rules could be extrapolated from the United Nations Sales Convention to govern dealings in services or "virtual goods", that is, items (such as software) that might be purchased and delivered in cyberspace. It was widely felt that, in undertaking such studies, careful attention would need to be given to the work of other international organizations such as the World Intellectual Property Organization (WIPO) and the World Trade Organization.

385. The second topic was dispute settlement. It was noted that the Working Group on Arbitration had already begun discussing ways in which current legal instruments of a statutory nature might need to be amended or interpreted to authorize the use of electronic documentation and, in particular, to do away with existing requirements regarding the written form of arbitration agreements. It was generally agreed that further work might be undertaken to determine whether specific rules were needed to facilitate the increased use of on-line dispute settlement mechanisms. In that context, it was suggested that special attention might be given to the ways in which dispute settlement techniques such as arbitration and conciliation might be made available to both commercial parties and consumers. It was widely felt that the increased use of electronic commerce tended to blur the distinction between consumers and commercial parties. However, it was recalled that, in a number of countries, the use of arbitration for the settlement of consumer disputes was restricted for reasons involving public policy considerations and might not easily lend itself to harmonization by international organizations. It was also felt that attention should be paid to the work undertaken in that area by other organizations, such as the International Chamber of Commerce (ICC), the Hague Conference on Private International Law and WIPO, which was heavily involved in dispute settlement regarding domain names on the Internet.

386. The third topic was dematerialization of documents of title, in particular in the transport industry. It was suggested that work might be undertaken to assess the desirability and feasibility of establishing a uniform statutory framework to support the development of contractual

[7]Ibid., *Fifty-third Session, Supplement No. 17* (A/53/17), paras. 207-211.

[8]Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), paras. 308-314.

schemes currently being set up to replace traditional paper-based bills of lading by electronic messages. It was widely felt that such work should not be restricted to maritime bills of lading, but should also envisage other modes of transportation. In addition, outside the sphere of transport law, such a study might also deal with issues of dematerialized securities. It was pointed out that the work of other international organizations on those topics should also be monitored.

387. After discussion, the Commission welcomed the proposal to undertake studies on the three topics. While no decision as to the scope of future work could be made until further discussion had taken place in the Working Group on Electronic Commerce, the Commission generally agreed that, upon completing its current task, namely, the preparation of draft uniform rules on electronic signatures, the Working Group would be expected, in the context of its general advisory function regarding the issues of electronic commerce, to examine, at its first meeting in 2001, some or all of the above-mentioned topics, as well as any additional topic, with a view to making more specific proposals for future work by the Commission at its subsequent meeting. It was agreed that work to be carried out by the Working Group could involve consideration of several topics in parallel as well as preliminary discussion of the contents of possible uniform rules on certain aspects of the above-mentioned topics.

388. Particular emphasis was placed by the Commission on the need to ensure coordination of work among the various international organizations concerned. In view of the rapid development of electronic commerce, a considerable number of projects with possible impact on electronic commerce were being planned or undertaken. The secretariat was requested to carry out appropriate monitoring and to report to the Commission as to how the function of coordination was fulfilled to avoid duplication of work and ensure harmony in the development of the various projects. The area of electronic commerce was generally regarded as one in which the coordination mandate given to UNCITRAL by the General Assembly could be exercised with particular benefit to the global community and deserved corresponding attention from the Working Group and the secretariat.

VI. SETTLEMENT OF COMMERCIAL DISPUTES

389. At its thirty-first session, the Commission held a special commemorative New York Convention Day on 10 June 1998 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 Secretary-General made the opening speech. In addition to speeches by participants in the diplomatic conference that had adopted the Convention, leading arbitration experts presented reports on matters such as the promotion of the Convention, its enactment and application. Reports were also made on matters beyond the Convention itself, such as the interplay between the Convention and other international legal texts on international commercial arbitration and on difficulties encountered in practice but addressed in existing legislative or non-legislative texts on arbitration.[9]

390. In reports presented at the commemorative conference, 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 related work by the Commission would be desirable and feasible. At its thirty-first session, in 1998, with reference to the discussions at the New York Convention Day, the Commission had considered that it would be useful to engage in a discussion of possible future work in the area of arbitration at its thirty-second session, in 1999 and had requested the secretariat to prepare a note that would serve as a basis for the considerations of the Commission.[10]

391. At its thirty-second session, in 1999, the Commission had had before it the note it had requested, entitled "Possible future work in the area of international commercial arbitration" (A/CN.9/460).[11] Welcoming the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration, the Commission had generally considered that the time had arrived to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985), as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.[12]

392. When the Commission discussed the topic, it left open the question of what form its future work might take. It was agreed that decisions on the matter should be taken later as the substance of proposed solutions became clearer. Uniform provisions might, for example, take the form of a legislative text (such as model legislative provisions or a treaty) or a non-legislative text (such as a model contractual rule or a practice guide). It was stressed that, even if an international treaty were to be considered, it was not intended to be a modification of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958).[13]

393. The Commission entrusted the work to one of its three working groups, which it named Working Group on

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[9] *Enforcing Arbitration Awards under the New York Convention: Experience and Prospects* (United Nations publication, Sales No. E.99.V.2).

[10] *Official Records of the General Assembly, Fifty-third Session, Supplement No. 17* (A/53/17), para. 235.

[11] The note drew on ideas, suggestions and considerations expressed in different contexts, such as the New York Convention Day (*Enforcing Arbitration Awards under the New York Convention*, op. cit.); the Congress of the International Council for Commercial Arbitration, Paris, 3-6 May 1998 (*Improving the Efficiency of Arbitration Agreements and Awards: 40 Years of Application of the New York Convention, International Council for Commercial Arbitration Congress Series No. 9*, Kluwer Law International, 1999); and other international conferences and forums, such as the 1998 Freshfields lecture by Gerold Herrmann, "Does the world need additional uniform legislation on arbitration?" (*Arbitration International*, vol. 15 (1999), No. 3, p. 211).

[12] Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), para. 337.

[13] Ibid., paras. 337-376 and 380.

Arbitration, and decided that the priority items for the Working Group should be conciliation,[14] requirement of written form for the arbitration agreement,[15] enforceability of interim measures of protection[16] and possible enforceability of an award that had been set aside in the State of origin.[17]

394. At its current session, the Commission had before it the report of the Working Group on Arbitration, which had held its thirty-second session in Vienna from 20 to 31 March 2000 (A/CN.9/468).

395. The Commission took note of the report with satisfaction and commended the work accomplished so far. Various observations were made to the effect that the work on the items on the agenda of the Working Group was timely and necessary in order to foster the legal certainty and predictability in the use of arbitration and conciliation in international trade. The Working Group, in addition to the topics referred to it as a matter of priority, had identified a number of other topics, with various levels of priority, that had been suggested for possible future work (A/CN.9/468, paras. 107-109). The Commission reaffirmed the mandate of the Working Group to decide on the time and manner of dealing with those topics.

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

397. The Commission heard statements by observers on behalf of the Chartered Institute of Arbitrators and the International Union of Lawyers. In addition to expressing appreciation for the work on arbitration and conciliation by the Commission and commenting on various items considered by the Working Group, they offered to assist in that work. The Commission took note of those statements with appreciation.

398. The Commission took note of paragraph 115 of the report of the Working Group referring to the considerations of the ECE Advisory Group on the European Convention on International Commercial Arbitration. The Advisory Group had concluded, inter alia, that the European Convention (Geneva, 1961) *(a)* remained useful; *(b)* had utility beyond that of existing conventions (in particular, as a common set of minimum standards to be observed in international arbitration); and *(c)* could be made even more useful to both existing and potential new contracting States if it were updated. The Commission also noted the recommendation of the Advisory Group to modify article IV of the Convention and the Agreement relating to Application of the European Convention on International Commercial Arbitration and that no consensus had been reached as to whether any additional changes to the Convention should be made.

399. The Commission called for coordination between the Working Group on Arbitration and the ECE Advisory Group. It was of the view that the ECE work should not overlap the work undertaken at the global level by the Commission. It was also of the view that issues arising from the European Convention beyond those in article IV were of universal interest and that, if it was found that they required work at the international level, the Commission, because of its universal representation and tradition in working in the area of international commercial arbitration, was the proper forum to undertake such work, in cooperation with ECE. The Commission appealed to States members of the Commission and observer States to coordinate within their respective Governments the work of their delegates in the two organizations considering international commercial arbitration.

VII. INSOLVENCY LAW

400. At its thirty-second session, in 1999, the Commission had had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law. The proposal referred to recent regional and global financial crises and the work undertaken in international forums in response to those crises. Reports from those forums stressed the need to strengthen the international financial system in three areas: transparency, accountability and management of international financial crises by domestic legal systems. According to those reports, strong insolvency and debtor-creditor regimes were important means of preventing or limiting financial crises and of facilitating rapid and orderly workouts from excessive indebtedness. The proposal before the Commission recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that had expertise and interest in the law of insol-

[14]Ibid., paras. 340-343.

[15]Ibid., paras. 344-350.

[16]Ibid., paras. 371-373.

[17]Ibid., paras. 374 and 375.

vency, the Commission was an appropriate forum for insolvency to be included in its agenda. The proposal urged that the Commission consider entrusting a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

401. The Commission had expressed its appreciation for the proposal. It noted that different work projects had been undertaken by other international organizations such as the International Monetary Fund (IMF), the World Bank and the International Bar Association on the development of standards and principles for insolvency regimes. The broad objective of those organizations, while differing in scope and working methods as a consequence of their respective mandates and membership, was to modernize insolvency practices and laws. The initiatives taken in those organizations demonstrated the need to assist States in reassessing their insolvency laws and practices. Those various initiatives, however, also needed strengthened coordination, where appropriate, so as to avoid inefficient duplication of work and to achieve consistent results.

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

403. To facilitate that further study, the Commission had decided that one session of a working group should be held to ascertain what, in the current landscape of efforts, would be an appropriate product (such as a model law, model provisions, a set of principles or other type of text) and to define the scope of the issues to be included in that product. It was pointed out that the importance and urgency of work on insolvency law had been identified in a number of international organizations and there was wide agreement that more work was required in order to foster the development and adoption of effective national corporate insolvency regimes.[18] Pursuant to that decision, the Working Group on Insolvency Law had held an exploratory session in Vienna from 6 to 17 December 1999.

404. At its thirty-third session, the Commission had before it the report of the Working Group on the work of its twenty-second session (A/CN.9/469).

405. It was noted that the Working Group had considered key objectives of an insolvency regime and a number of core features of a national insolvency regime. The Working Group had then reviewed various possible forms that an instrument that the Commission might decide to prepare might take, such as a comparative study, a guide that outlined practices and policy choices, a legislative guide with a similar approach as the legislative guide on privately financed infrastructure projects and model statutory provisions. It was also noted that the Working Group had agreed that a universal, one-size-fits-all solution would not be feasible or desirable. However, there was agreement in the Working Group that a legislative approach should be followed (A/CN.9/469, paras. 125-134).

406. The Commission welcomed the report of the Working Group on Insolvency Law. There was general agreement in the Commission that a single model law on insolvency was neither feasible nor necessary. It was not feasible because national laws took different approaches and were making different policy choices in the area of insolvency law; it was therefore unrealistic to expect that a single universal model might be agreed upon. It was also not necessary to promote a single model, since it was more important for the facilitation of international trade to have a consistent and predictably applied insolvency regime than a uniform regime.

407. The Commission took note of the discussions in the Working Group concerning the possible need for a statutory text governing informal insolvency procedures including out-of-court restructuring, which would also include the possibility of binding dissenting creditors (A/CN.9/469, paras. 105–121). Reservations were expressed in the Commission regarding the proposition of developing such a regime. It was argued that informality and flexibility were important hallmarks of negotiations aiming at out-of-court restructuring and that subjecting such an informal process to scrutiny by a court or another body might disturb the process in an undesirable manner. It was also said that the best way to foster out-of-court restructuring procedures was to set up an effectively functioning regime governing formal, court-supervised insolvency proceedings. It was therefore suggested that any work on out-of-court restructuring should be considered together with, and in the broader context of, work towards a modern national insolvency regime.

408. Several references were made to the fact that various international organizations were considering (from different perspectives and aiming at not necessarily the same issues) the modernization of national insolvency regimes. Those organizations included, in particular, the World Bank, IMF, the Asian Development Bank, the International Federation of Insolvency Professionals (INSOL International) and Committee J of the International Bar Association. If the Working Group were to be given a mandate to continue its work, the views and results of work of those organizations should be taken into account in preparing the documentation for the Working Group. It was therefore suggested that a colloquium should be held (similar to the UNCITRAL/INSOL Colloquium held in Vienna in 1994, which had preceded the work leading to the subsequent adoption of the UNCITRAL Model Law on Cross-Border Insolvency (see A/CN.9/398). On behalf of INSOL International and Com-

[18]Ibid., paras. 381-385.

mittee J of the International Bar Association, an offer was made to cooperate with the secretariat in organizing such a colloquium before the next session of the Working Group so as to facilitate considerations in the Group.

409. The Commission noted the recommendation that the Working Group had made in its report (A/CN.9/398, para. 140) and fully accepted it by giving the Group the mandate to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring, and a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches. A legislative guide similar to that adopted by the Commission for privately financed infrastructure projects would be useful and could contain model legislative provisions, where appropriate. It was agreed that in carrying out its task the Working Group should be mindful of the work under way or already completed by other organizations, including IMF, the World Bank, the Asian Development Bank, INSOL International and the International Bar Association. It was noted that, in order to obtain the views and benefit from the expertise of those organizations, the secretariat would organize a colloquium before the next session of the Working Group, in cooperation with INSOL International and the International Bar Association, as had been offered by those organizations.

VIII. MONITORING THE IMPLEMENTATION OF THE 1958 NEW YORK CONVENTION

410. 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).[19] It was stressed that the purpose of the project, as approved by the Commission, was limited to that aim and, in particular, that its purpose was not to monitor individual court decisions applying the Convention. 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.

411. As at the beginning of the thirty-third session of the Commission, the secretariat had received 59 replies to the questionnaire (out of a current total of 121 States parties).

412. The Commission repeated its appeal to 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 an analysis of the information gathered.

[19]Ibid., *Fiftieth Session, Supplement No. 17* (A/50/17), paras. 401-404, and ibid., *Fifty-first Session, Supplement No. 17* (A/51/17), paras. 238-243.

IX. CASE LAW ON UNCITRAL TEXTS

413. The Commission noted with appreciation the ongoing work under the system that had been established for the collection and dissemination of case law on UNCITRAL texts (CLOUT). It was noted that CLOUT was a most important means of promoting the uniform interpretation and application of UNCITRAL texts by enabling interested persons, such as judges, arbitrators, lawyers or parties to commercial transactions to take into account decisions and awards of other jurisdictions when rendering their own judgements or opinions or adjusting their actions to the prevailing interpretation of those texts.

414. The Commission expressed appreciation to the national correspondents for their valuable work in the collection of relevant decisions and arbitral awards and their preparation of case abstracts. It also expressed its appreciation to the secretariat for compiling, editing, issuing and distributing case abstracts. It was noted that, whereas 62 jurisdictions had appointed national correspondents, there were another 26 jurisdictions that had not yet done so. Those jurisdictions would be entitled to make such an appointment either by virtue of their being party to an UNCITRAL convention currently in force or by having adopted legislation based on an UNCITRAL model law. Noting the importance of uniform reporting from all jurisdictions, the Commission urged States that had not yet done so to appoint a national correspondent. It also urged Governments to assist their national correspondents to the extent possible in their work.

415. It was also noted that the number of States adhering to conventions or enacting legislation based on model laws drawn up by the Commission had increased significantly. The concern was expressed that, with the resultant increase in the caseload, the continuation of CLOUT would be at risk without a significant increase in the human and financial resources available to the secretariat of the Commission.

X. TRANSPORT LAW

416. It was recalled that at its twenty-ninth session, in 1996, the Commission had requested the secretariat to be the focal point for gathering information, ideas and opinions as to problems in transport law that arose in practice and possible solutions to those problems. Such information-gathering should be broadly based and should include among its sources, in addition to Governments, international organizations representing the commercial sectors involved in the carriage of goods by sea, such as the International Maritime Committee (CMI), ICC, 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.[20]

[20]Ibid., *Fifty-first Session, Supplement No. 17* (A/51/17), paras. 210-215.

417. At its thirty-first session, in 1998, the Commission heard a statement on behalf of CMI to the effect that it welcomed the invitation to cooperate with the secretariat in soliciting views of the sectors involved in the international carriage of goods and in preparing an analysis of that information. That analysis would allow the Commission to take an informed decision as to the desirable course of action.[21] Strong support had been expressed at that session by the Commission for the exploratory work being undertaken by CMI and the secretariat of the Commission. The Commission expressed its appreciation to CMI for its willingness to embark on that important and far-reaching project, for which few or no precedents existed at the international level; the Commission was looking forward to being apprised of the progress of the work and to considering the opinions and suggestions resulting from it.[22]

418. At the thirty-second session of the Commission, in 1999, it was reported on behalf of CMI that the Assembly and the Executive Council of CMI had welcomed the initiative to collect data on issues related to international transport law that had so far not been internationally harmonized and that a CMI working group had been instructed to prepare a study on a broad area of issues in international transport law with the aim of identifying the areas where unification or harmonization were needed by the industries involved. In undertaking the study, it had been realized that the industries involved were extremely interested in pursuing the project and had offered their technical and legal knowledge to assist in that endeavour. Based on that favourable reaction and the preliminary findings of the CMI working group, it appeared that further harmonization in the field of transport law would greatly benefit international trade. The working group had found a number of issues that had not been covered by the current unifying instruments. Some of the issues were regulated by national laws, which, however, were not internationally harmonized. Evaluated in the context of electronic commerce, that lack of harmonization became even more significant. It was also reported that the working group had identified numerous interfaces between the different types of contracts involved in international trade and transport of goods (such as sales contracts, contracts of carriage, insurance contracts, letters of credit, freight forwarding contracts, as well as a number of other ancillary contracts). The working group intended to clarify the nature and function of those interfaces and to collect and analyse the rules currently governing them. That exercise would at a later stage include a re-evaluation of principles of liability as to their compatibility with a broader area of rules on the carriage of goods.

419. At the same session, the Commission had expressed its appreciation to CMI for having acted upon its request for cooperation and had requested the secretariat to continue to cooperate with CMI in gathering and analysing information. The Commission was looking forward to receiving a report at a future session presenting the results of the study and proposals for future work.[23]

420. At the current session, the Commission had before it a report of the Secretary-General on possible future work in transport law (A/CN.9/476), which described the progress of the work carried out by CMI in cooperation with the secretariat of the Commission. It also heard an oral report on behalf of CMI. In cooperation with the secretariat of the Commission, the CMI working group had launched an investigation based on a questionnaire covering different legal systems addressed to the CMI member organizations. At the same time, a number of round-table meetings had been held in order to discuss features of the future work with international organizations representing various industries. Those meetings showed the continued support and interest of the industry in the project.

421. Pursuant to the receipt of replies to the questionnaire, CMI had created an international subcommittee with a view to analysing the information and finding a basis for further work towards harmonizing the law in the area of international transport of goods. It was reported that the enthusiasm encountered so far in the industry and the provisional findings about the areas of law that needed further harmonization made it likely that the project would be eventually transformed into a universally acceptable harmonizing instrument.

422. In the course of the discussions in the CMI subcommittee, it had been noted that although bills of lading were still used, especially where a negotiable document was required, the actual carriage of goods by sea sometimes represented only a fragment of an international transport of goods. In the container trade, even a port-to-port bill of lading would involve receipt and delivery at some point not directly connected with the loading on to, or discharge from, the ocean vessel. Moreover, in most situations it was not possible to take delivery alongside the vessel. Furthermore, where different modes of transport were used, there were often gaps between mandatory regimes applying to the various transport modes involved. It had been proposed, therefore, that in developing an internationally harmonized regime covering the relationships between the parties to the contract of carriage for the full duration of the carrier's custody of the cargo, issues that arose in connection with activities that were integral to the carriage agreed to by the parties and that took place before loading and after discharge should also be considered, as well as issues that arose under shipments where more than one mode of transport was contemplated. Furthermore, while the emphasis of the work, as originally conceived, had been on the review of areas of law governing the transport of goods that had not previously been covered by international agreement, it had been increasingly felt that the current broadly based project should be extended to include an updated liability regime that would complement the terms of the proposed harmonizing instrument.

423. The Commission took note with satisfaction of the report of the Secretary-General (A/CN.9/476) and heard with pleasure the oral report on behalf of CMI of the preliminary work accomplished thus far.

424. Several statements were made in the Commission to the effect that the time had come to pursue actively harmonization in the area of the carriage of goods by sea, that

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

[22] Ibid., para. 266.

[23] Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), para. 418.

increasing disharmony in the area of international carriage of goods was a source of concern and that it was necessary to provide a certain legal basis to modern contract and transport practices. The carriage of goods by sea was increasingly part of a warehouse-to-warehouse operation and that factor should be borne in mind in conceiving future solutions. Approval was expressed for a concept of work that went beyond liability issues and dealt with the contract of carriage in such a way that it would facilitate the export-import operation, which included the relationship between the seller and the buyer (and possible subsequent buyers) as well as the relationship between the parties to the commercial transaction and providers of financing. It was recognized that such a broad approach would involve some re-examination of the rules governing the liability for loss of or damage to goods.

425. It was observed that the work of some regional organizations, such as the Organization of American States and ECE, were currently considering transport law issues. It was considered that the texts already formulated in those organizations would be useful in the work of the Commission and also that the work in those organizations would be facilitated by universally applicable texts to be developed in the Commission. It was observed that ECE was currently considering whether to undertake work on uniform rules for the multimodal transport of goods. Concern was expressed that, if any such work were to be undertaken by an organization in which not all regions of the world were represented, it would interfere with efforts to prepare a universally applicable regime. Hope was expressed that the organizations concerned would coordinate their work so as to avoid duplication and that States would be mindful of the need for coordination within their own administrations of the work of their delegates in those organizations.

426. The Commission took note of the fact that the secretariat was organizing in cooperation with CMI a Transport Law Colloquium to be held on 6 July 2000 in the context of the current session of the Commission. The purpose of the Colloquium was to gather ideas and expert opinions on problems that arose in the international carriage of goods, in particular the carriage of goods by sea, and to incorporate that information into the report to be presented to the Commission at its thirty-fourth session, in 2001.

427. The Commission was pleased with the progress made since its thirty-second session. It welcomed the fruitful cooperation between CMI and the secretariat. Several statements were made to the effect that it was necessary throughout the preparatory work to involve the other interested organizations, including those representing the interests of cargo owners. It was stressed that only by ensuring the cooperation of all interested industries at all stages of the preparatory work was there hope to develop a regime that would be both broadly acceptable and capable of being implemented within a short span of time. The Commission requested the secretariat to continue to cooperate actively with CMI with a view to presenting, at the next session of the Commission, a report identifying issues in transport law in respect of which the Commission might undertake future work and, to the extent possible, also presenting possible solutions.

XI. ENDORSEMENT OF TEXTS OF OTHER ORGANIZATIONS: INCOTERMS 2000, ISP98 AND URCB

428. The Commission had before it three reports of the Secretary-General requesting the Commission's endorsement of *(a)* the International Standby Practices (ISP98), *(b)* the Uniform Rules for Contract Bonds (URCB) and *(c)* Incoterms 2000 (A/CN.9/477, A/CN.9/478 and A/CN.9/479, respectively).

429. It was recalled that at its thirty-second session the Commission had been requested by the Institute of International Banking Law and Practice to consider recommending for worldwide use the Rules on International Standby Practices (ISP98), as endorsed by the Commission on Banking Technique and Practice of ICC. The Commission had also been notified of a request from the Secretary-General of ICC that the Commission consider giving its formal recognition and endorsement of URCB. In order to allow consideration of those requests, the Commission had before it the text of ISP98 (A/CN.9/459) and of URCB (A/CN.9/459/Add.1). However, while several delegations had indicated their desire to endorse the texts of ISP98 and URCB at that session, some delegations had indicated that, owing to the fact that late publication of the documents containing the latter text had prevented them from carrying out the consultations required prior to endorsement, they were not prepared to endorse the texts of ISP98 and URCB at that session. The Commission had regretfully felt obliged to postpone consideration of endorsement until the thirty-third session.[24]

430. At the thirty-third session, as had already been the case at the thirty-second session, reference was made to the importance of ISP98 as private rules of practice intended to apply to standby letters of credit. It was pointed out that the idea of preparing such rules had been conceived during the deliberations of the UNCITRAL Working Group on International Contract Practices, which had resulted in the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit. The ISP98 Rules had been formulated to complement the Convention. The ISP98 drafting process itself had been undertaken in regular consultation with the UNCITRAL secretariat and had also been used as an opportunity to promote adoption of the Convention. In that context, the Commission recalled with particular appreciation that adoption of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit had been recommended to Governments by the Banking Commission of ICC. Reference was also made to the importance of URCB as a commendable practical tool and to the need for wider awareness of that instrument.

431. The Commission welcomed the opportunity to foster its cooperation with ICC. It was recalled that the Commission had endorsed Incoterms 1990 at its twenty-fifth session, in 1992,[25] and the Uniform Customs and Practice for Documentary Credits (UCP 500) at its twenty-seventh session, in 1994.[26] while it was generally felt that the technical

[24]Ibid., paras. 422-425.

[25]Ibid., *Forty-seventh Session, Supplement No. 17* (A/47/17), para. 161.

[26]Ibid., *Forty-ninth Session, Supplement No. 17* and corrigendum (A/49/17 and Corr.1), para. 230.

quality of ISP98 and URCB made those instruments worthy of wider dissemination and use in international trade, a question was raised as to the meaning of an endorsement of those instruments by the Commission. It was pointed out that, in a number of countries, not all provisions of ISP98 would be in conformity with existing legal rules, which might not fully recognize, for example, the role of stand-by letters of credit as independent guarantees. In that connection, concern was expressed that the notion of "endorsement" (which in a number of language versions was a synonym for "approval") should not be misinterpreted as indicating that, once they had been "endorsed", the instruments in their totality would necessarily become applicable in any country.

432. In response to that concern, it was generally agreed that, in the context of legal instruments emanating from other international organizations, "endorsement" should be interpreted as an indication by the Commission that those instruments were commended for use by the parties as a record of good international commercial practices. However, such an "endorsement" should carry no implication as to the conformity of those instruments with existing law. In addition, it was pointed out that the text of ISP98 itself made it clear that it was not intended to displace any provision of applicable law, since article 1.02.a indicated that the rules contained in ISP98 were intended to "supplement the applicable law to the extent not prohibited by that law".

433. With respect to Incoterms 2000, consistent with its previous endorsement of the text of Incoterms 1990 at its twenty-fifth session, in 1992,[25] the Commission expressed its appreciation for the efforts that had led to the development of those rules of practice and welcomed the request for their endorsement.

434. After discussion, the Commission adopted the following decision, endorsing the text of Incoterms 2000, ISP98 and URCB:

The United Nations Commission on International Trade Law,

Expressing its appreciation to the International Chamber of Commerce for having transmitted to it the revised text of Incoterms 2000, the Rules on International Standby Practices (ISP98) and the Uniform Rules for Contract Bonds (URCB),

Congratulating the International Chamber of Commerce on having made a further contribution to the facilitation of international trade by revising Incoterms to adapt them to contemporary commercial practice, by adopting the Rules on International Standby Practices (ISP98), as prepared by the Institute of International Banking Law and Practice, and by elaborating the Uniform Rules for Contract Bonds (URCB),

Noting that Incoterms 2000, the Rules on International Standby Practices (ISP98) and the Uniform Rules for Contract Bonds (URCB) constitute a valuable contribution to the facilitation of international trade,

Commends the use of Incoterms 2000, the Rules on International Standby Practices (ISP98) and the Uniform Rules for Contract Bonds (URCB) by the parties in international trade and financing transactions.

XII. TRAINING AND TECHNICAL ASSISTANCE

435. The Commission had before it a note by the secretariat (A/CN.9/473) setting forth the activities undertaken since its thirty-second session and indicating the direction of future activities being planned, in particular in view of the increase in the requests received by the secretariat. It was noted that training and technical assistance activities were typically carried out through seminars and briefing missions, which were designed to explain the salient features of UNCITRAL texts and the benefits to be derived from their adoption by States.

436. It was reported that, since the previous session, the following seminars and briefing missions had been organized: Johannesburg, South Africa (6 and 7 May 1999); Stellenbosch, South Africa (9 and 10 May 1999); Pretoria (11 and 12 May 1999); Yaoundé (10-12 May 1999); Abidjan (13 and 14 May 1999); Rio de Janeiro, Brazil (12 and 13 August 1999); Lima (19 and 20 August 1999); Cuzco, Peru (23-25 August 1999); Brasilia (30 and 31 August 1999); São Paulo, Brazil (2 and 3 September 1999); Moscow (2-4 November 1999); and Antananarivo (6-8 March 2000). The secretariat of the Commission reported that a number of requests had had to be turned down for lack of sufficient resources and that for the remainder of 2000 only some of the requests made by countries in Africa, Asia, Latin America and Eastern Europe could be met.

437. The Commission expressed its appreciation to the secretariat for the activities undertaken since its previous session and emphasized the importance of the training and technical assistance programme for promoting awareness and the wider adoption of the legal texts it had produced. Training and technical assistance were particularly useful for developing countries lacking expertise in the areas of trade and commercial law covered by the work of UNCITRAL and the training and technical assistance activities of the secretariat could play an important role in the economic integration efforts being undertaken by many countries.

438. The Commission noted the various forms of technical assistance that might be provided to States preparing legislation based on UNCITRAL texts, such as review of preparatory drafts of legislation from the point of view of UNCITRAL texts, preparation of regulations implementing such legislation and comments on reports of law reform commissions, as well as briefings for legislators, judges, arbitrators, procurement officials and other users of UNCITRAL texts as embodied in national legislation. The upsurge in commercial law reform represented a crucial opportunity for the Commission to further significantly the objectives of substantial coordination and acceleration of the process of harmonization and unification of international trade law, as envisaged by the General Assembly in its resolution 2205 (XXI) of 17 December 1966.

439. The Commission took note with appreciation of the contributions made by Canada, Cyprus, Greece, Mexico, Switzerland and the United Kingdom of Great Britain and Northern Ireland towards the seminar programme. It also expressed its appreciation to Singapore for its contribution

to the Trust Fund for Granting Travel Assistance to Developing States members of UNCITRAL. The Commission furthermore expressed its appreciation to those other States and organizations which had contributed to its programme of training and assistance by providing funds or staff or by hosting seminars. Stressing the importance of extrabudgetary funding for carrying out training and technical assistance activities, the Commission appealed once again to all States, international organizations and other interested entities to consider making contributions to the UNCITRAL trust funds so as to enable the secretariat of the Commission to meet the increasing demands in developing countries and newly independent States for training and assistance and to enable delegates from developing countries to attend UNCITRAL meetings. It was also suggested that, in order to resolve the resource difficulties facing the Commission, an attempt should be made to encourage the private sector to contribute to the financing of the UNCITRAL assistance and training programme, in particular since the private sector benefited a great deal from the overall work of the Commission in the area of international trade law.

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

441. As regards the internship programme of the secretariat of the Commission, concern was expressed that the majority of the participants 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.

442. In order to ensure the effective implementation of its training and assistance programme and the timely publication and dissemination of its work, the Commission decided to recommend to the General Assembly that it request the Secretary-General to increase substantially both the human and the financial resources available to its secretariat.

XIII. STATUS AND PROMOTION OF UNCITRAL TEXTS

443. On the basis of a note by the secretariat (A/CN.9/462), the Commission considered the status of the conventions and model laws emanating from its work, as well as the status of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). The Commission noted with pleasure the new action of States and jurisdictions subsequent to 4 June 1999 (date of the conclusion of the thirty-second session of the Commission) regarding the following instruments:

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

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

(c) United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules). Number of States parties: 26;

(d) United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980). Number of States parties: 56;

(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 additional 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 two States parties; it requires three additional adherences for entry into force;

(g) United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (New York, 1995). The Convention has five States parties;

(h) Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). Number of States parties: 121;

(i) UNCITRAL Model Law on International Commercial Arbitration, 1985. New jurisdiction that has enacted legislation based on the Model Law: Macau Special Administrative Region of China;

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

(k) UNCITRAL Model Law on Procurement of Goods, Construction and Services, 1994;

(l) UNCITRAL Model Law on Electronic Commerce, 1996. New jurisdictions that have enacted legislation based on the Model Law: Australia, Bermuda, France and Hong Kong Special Administrative Region of China. Uniform legislation influenced by the Model Law and the principles on which it is based has been prepared in Canada and in the United States of America;

(m) UNCITRAL Model Law on Cross-Border Insolvency, 1997. New jurisdictions that have enacted legislation based on the Model Law: Eritrea and Mexico.

444. 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 action.

445. 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 adop-

tion of legislation based on various model laws prepared by UNCITRAL. It was noted that the UNCITRAL Model Law on Electronic Commerce had become the single common source often cited by many countries.

446. It was noted that, despite the universal relevance and usefulness of those texts, a number of States had not yet enacted any of them. An appeal was directed to the representatives and observers who had been participating in the meetings of the Commission and its working groups to contribute, to the extent that they in their discretion deemed appropriate, to facilitating consideration by legislative organs in their countries of texts of the Commission.

XIV. GENERAL ASSEMBLY RESOLUTION ON THE WORK OF THE COMMISSION

447. The United Nations Commission on International Trade Law took note with appreciation of General Assembly resolution 54/103 of 9 December 1999 on the report of the Commission on the work of its thirty-second session. In particular, the Commission noted with appreciation that, in paragraph 2 of that resolution, the Assembly had commended 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, adopted in New York on 10 June 1958.

448. The Commission also noted with appreciation that, in paragraph 3 of resolution 54/103, the General Assembly had appealed to Governments that had 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.

449. The Commission further noted with appreciation that, in paragraph 5 of resolution 54/103, the Assembly had reaffirmed the mandate of the Commission, as the core legal body within the United Nations system in the field of international trade law, to coordinate legal activities in that field, and in that connection had 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 had 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.

450. The Commission noted with appreciation the decision of the General Assembly, in paragraph 6 of resolution 54/103, 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 7, the Assembly had expressed the desirability for increased efforts by the Commission, in sponsoring seminars and symposia, to provide such training and assistance.

451. The Commission also noted with appreciation the appeal by the General Assembly, in paragraph 7 *(b)* of the resolution, 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 had appealed, in paragraph 8, 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.

452. It was also appreciated that the General Assembly, in paragraph 9 of the resolution, had appealed to Governments, the relevant United Nations organs, organizations, institutions and individuals, in order to ensure full participation by all member States in the sessions of the Commission and its working groups, to make voluntary contributions to the trust fund for travel assistance to developing countries that are members of the Commission, at their request and in consultation with the Secretary-General. (The trust fund was established pursuant to Assembly resolution 48/32 of 9 December 1993.) The Commission further noted with appreciation the decision of the General Assembly, in paragraph 10 of resolution 54/103, to continue, in the competent Main Committee during the fifty-fourth session of the Assembly, its consideration of granting travel assistance, within existing resources, to the least developed countries that were members of the Commission, at their request and in consultation with the Secretary-General.

453. The Commission welcomed the request by the General Assembly, in paragraph 11 of the resolution, to the Secretary-General to ensure and enhance the effective implementation of the programme of the Commission. The Commission noted, however, that the resources available to its secretariat were not sufficient for it to implement its mandate. The Commission noted, in particular, that its secretariat had fewer Professional staff than it had had when the Commission was established. It therefore recommended to the Assembly that it request the Secretary-General to strengthen the secretariat of the Commission, within the resources available to the secretariat as a whole, so as to enable it to meet the need for increased efforts in trade law unification and harmonization and in trade law reform assistance so as to assist countries in sharing in the benefits of international trade in a global economy.

454. The Commission also noted with appreciation that the General Assembly, in paragraph 12, had stressed the importance of bringing into effect the conventions emanating from the work of the Commission and that to that end it had urged States that had not yet done so to consider signing, ratifying or acceding to those conventions.

XV. COORDINATION AND COOPERATION: SECURITY INTERESTS

455. The Commission considered work undertaken by other organizations in the field of security interests on the basis of a report of the Secretary-General (A/CN.9/475). It was noted that the subject of security interests was becoming increasingly important, at both the international level and the national level, in particular in view of the potential of modern secured credit laws to increase the availability of lower-cost credit and thus enhance the cross-border movement of goods and services. It was also noted that a number of texts had been or were currently being prepared that, while indicating certain common trends, left a number of issues unaddressed. The following problems were identified: inadequacy of domestic laws, in particular with regard to international transactions and in view of the fact that mandatory law and public policy issues were involved in secured transactions; the friction resulting from the possibility that more than one country's law might govern a security interest; and the loss of security if the collateral crossed national borders. A wide variety of possible solutions were mentioned, ranging from a model law dealing with security interests in all types of asset, to a statement of principles with a guide, a model law for priority systems based on registration or a convention or model law dealing with particular types of asset (e.g. investment securities or intellectual property).

456. The observer from the secretariat of Unidroit stated that in 1980, after UNCITRAL had assigned low priority to the subject of security interests by discontinuing work for the time being, Unidroit, having invested significant resources, had become the premier organization to undertake and coordinate work in the field of secured credit law. Unidroit's efforts were reflected in two conventions completed and one draft convention being prepared. Furthermore, in 1993, Unidroit had started work on the preparation of a model law on security interests. While the Governing Council of Unidroit had in 1995 assigned low priority to that project in view of the need for Unidroit to complete its work on mobile equipment, once that work was completed, Unidroit could be expected to resume its work on the model law. As a result, it was suggested that UNCITRAL should not undertake overlapping work in the field of security interests, thus avoiding any duplication of efforts. It was also observed that the report of the Secretary-General might have been based on a misunderstanding of the plans of Unidroit in that regard (A/CN.9/475, paras. 8 and 9).

457. In response, it was noted that coordination of the work of other organizations in the field of international trade law was at the heart of the mandate of UNCITRAL as a body in the work of which all States could participate on an equal footing and in all six official languages of the United Nations. It was also noted that the report by the secretariat accurately reflected the fact that no action had been taken since 1995, since the matter was not on the priority list of Unidroit, as indicated in Unidroit papers, including the Unidroit work programme for the triennium 1999-2001, and confirmed by the observer from the Unidroit secretariat at both the thirty-second and thirty-third sessions of the Commission.[27]

458. The Commission, as the core legal body in the United Nations system in the field of the unification and harmonization of international trade law, reaffirmed its mandate to monitor work carried out in other organizations in the field of international trade law, issuing recommendations, when necessary, and to take any other action to carry out its mandate. With regard to the concern expressed as to the risk that any work by UNCITRAL in the field of secured credit law might duplicate work carried out in other organizations, the Commission agreed that such a duplication could be avoided with a cautious, measured approach that would focus on particular types of asset. It was widely felt that the topic of security interests was so broad and the issues involved so complex that it would take work by several organizations to address all problems (as to the particular suggestions made, see paras. 460-462 below). It was agreed that it would be the responsibility of all relevant organizations to cooperate with a view to ensuring consistency between the various texts and efficiency in the utilization of resources.

459. Expressing its appreciation for the report of the Secretary-General, the Commission went on to consider the substance of that report. It was generally agreed that security interests was an important subject and had been brought to the attention of the Commission at the right time, in particular in view of the close link of security interests with the work of the Commission on insolvency law. It was widely felt that modern secured credit laws could have a significant impact on the availability and the cost of credit and thus on international trade. Modern secured credit laws could alleviate the inequalities in the access to lower-cost credit between parties in developed countries and parties in developing countries, and in the share such parties had in the benefits of international trade. A note of caution was struck in that regard to the effect that such laws needed to strike an appropriate balance in the treatment of privileged, secured and unsecured creditors so as to become acceptable to States. It was also stated that, in view of the divergent policies of States, a flexible approach aimed at the preparation of a set of principles with a guide, rather than a model law, would be advisable. Furthermore, in order to ensure the optimal benefits from law reform, including financial-crisis prevention, poverty reduction and facilitation of debt financing as an engine for economic growth, any effort on security interests would need to be coordinated with efforts on insolvency law.

460. As to the focus of any work to be undertaken, a number of suggestions were made. One suggestion was that a uniform law should be prepared to deal with security interests in investment property (e.g. stocks, bonds, swaps and derivatives). Such securities, which were held, as entries in a register, by an intermediary and, physically, by a depositary institution, were important instruments on the basis of which vast amounts of credit were extended not only by commercial banks to their clients but also by central banks to commercial banks. It was also observed that, in view of the globalization of financial markets, a number of jurisdictions were normally involved, the laws of which were often incompatible with each other or even inadequate to address the relevant problems. As a result, a great deal of uncertainty existed as to whether investors owning securities and financiers extending credit and taking a pledge in

[27] Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), para. 420.

the securities had a right in rem and were protected, in particular, in the case of the insolvency of an intermediary. It was also pointed out that a great deal of uncertainty arose even as to the law applicable to security interests in investment property held by an intermediary and that the fact that the Hague Conference on Private International Law planned to address that matter indicated both its importance and its urgency. In that regard, it was observed that work by UNCITRAL could be perfectly compatible with and could usefully supplement any work undertaken by the Hague Conference, in particular in view of the inherent limitations of private international law rules in matters of mandatory law and public policy.

461. Another suggestion was that a uniform law should be prepared to deal with security interests in inventory (i.e. a constantly changing pool of tangible assets). It was stated that the use of a changing pool of assets, whether tangible or intangible, was an important feature of modern secured financing law. It was also observed that any work on inventory could usefully draw on the Commission's work on receivables and on practices that would be likely to draw a positive response from international financial markets. The following matters were mentioned as matters that would need to be addressed in such a uniform law: the creation and scope of a security interest (which should include property acquired, and secure debts arising, even after the creation of the interest); remedies upon default of the debtor; clear priority rules; and mechanisms ensuring the transparency of any interest.

462. Yet another suggestion was that a uniform law should be prepared to deal with an international register of security rights. Such a register would enhance certainty and transparency and, as a result, have a positive impact on the availability and the cost of credit, which was badly needed for the development of the world economy. To achieve that result, the register should encompass all types of security interest in all types of asset. In the discussion, the suggestion was made that a colloquium might be held by the secretariat in cooperation with organizations representing the relevant practice and industry as well as with international development institutions.

463. After discussion, the Commission requested the secretariat to prepare a study that would discuss in detail the relevant problems in the field of secured credit law and the possible solutions for consideration by the Commission at its thirty-fourth session, in 2001. It was agreed that, after considering the study, the Commission could decide at that session whether further work could be undertaken, on which topic and in which context. It was also agreed that the study could examine, in particular, whether current trends established sufficient common ground among legal systems to make the preparation of a uniform law within a reasonable period of time feasible. It was further agreed that the study could discuss the advantages and disadvantages of the various solutions (i.e. a uniform law on all types of asset as compared with a set of principles with a guide or a uniform law on specific types of asset). Moreover, it was agreed that the study should draw upon and build on work carried out by other organizations and that any suggestions should take into account the need to avoid duplication of efforts.

XVI. OTHER BUSINESS

A. Bibliography

464. The Commission noted with appreciation the bibliography of recent writings related to the work of the Commission (A/CN.9/481).

465. The Commission stressed that it was important for it to have information that was as complete as possible with regard to 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

466. It was reported to the Commission that the Institute of International Commercial Law at Pace University School of Law, New York, had organized the seventh Willem C. Vis International Commercial Arbitration Moot in Vienna from 15 to 20 April 2000. Legal issues dealt with by the teams of students participating in the Moot had been based on the United Nations Convention on Contracts for the International Sale of Goods, the UNCITRAL Model Law on International Commercial Arbitration and the Arbitration Rules of the London Court of International Arbitration. In the 2000 Moot, some 79 teams had participated from law schools in some 28 countries, involving about 600 students and tutors and about 150 arbitrators. The eighth Moot is to be held at Vienna from 6 to 12 April 2001.

467. The Commission heard the report with interest. Special appreciation was expressed to the Institute of International Commercial Law at Pace University School of Law for organizing the Moot and to the secretariat for sponsoring it. The Commission regarded the Moot, with its broad international participation, as an excellent method of disseminating information about uniform law texts and teaching international trade law.

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

468. It was decided that the Commission would hold its thirty-fourth session in Vienna from 25 June to 13 July 2001.

D. Sessions of working groups

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

(a) The Working Group on Electronic Commerce is to hold its thirty-seventh session in Vienna from 18 to 29 September 2000 and its thirty-eighth session in New York from 26 February to 9 March 2001;

(b) The Working Group on Arbitration is to hold its thirty-third session in Vienna from 20 November to 1 December 2000 and its thirty-fourth session in New York from 21 May to 1 June 2001;

(c) The Working Group on International Contract Practices is to hold its twenty-third session in Vienna from 11 to 22 December 2000 and its twenty-fourth session, as the Working Group on Insolvency Law, in New York from 26 March to 6 April 2001.

E. Retirement of the Secretary of the Commission

470. The Commission noted that its Secretary, Mr. Gerold Herrmann, was to retire on 31 January 2001. Mr. Herrmann had served as a member of the secretariat since 1975 and as Secretary of the Commission since 1991. It was widely recognized that the time during which Mr. Herrmann had served as Secretary of the Commission had been a most productive one and that the secretariat of the Commission under the leadership of Mr. Herrmann had made an excellent contribution to that work despite the limited resources available to it. The Commission expressed its appreciation to Mr. Herrmann for his outstanding contribution to the process of unification and harmonization of international trade law in general and to UNCITRAL in particular.

ANNEX I

Draft Convention on Assignment of Receivables in International Trade

*(Title, preamble and draft articles 1-17 as adopted by the Commission)**

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 content and the choice of legal regime applicable to the assignment of receivables constitute an obstacle to international trade,

Desiring to establish principles and adopt rules relating to the assignment of receivables that would create certainty and transparency and promote modernization of law relating to assignments of receivables, while protecting existing assignment practices and facilitating the development of new practices,

Desiring also to ensure the adequate protection of the interests of the debtor in the case of an assignment of receivables,

Being of the opinion that the adoption of uniform rules governing the assignment of receivables would promote the availability of capital and credit at more affordable rates and thus facilitate the development of international trade,

Have agreed as follows:

*Articles 18-44 of the draft convention and articles 1-7 of the annex to the draft convention, not yet considered by the Commission, appear in annex I to document A/CN.9/466, with an analytical commentary by the secretariat in document A/CN.9/470 and comments by Governments and international organizations in documents A/CN.9/472 and Add.1-4.

CHAPTER I

Scope of application

Article 1
Scope of application

1. This Convention applies to:

(a) Assignments of international receivables and to international assignments of receivables as defined in this chapter, if, at the time of the conclusion of the contract of assignment, the assignor is located in a Contracting State; and

(b) Subsequent assignments provided that any prior assignment is governed by this Convention.

2. This Convention applies to a subsequent assignment that satisfies the criteria of paragraph 1 *(a)* of this article, notwithstanding that it did not apply to any prior assignment of the same receivable.

3. This Convention does not affect the rights and obligations of the debtor unless, at the time of the conclusion of the original contract, the debtor is located in a Contracting State or the law governing the receivable is the law of a Contracting State.

[4. The provisions of chapter V 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. However, those provisions do not apply if a State makes a declaration under article 37.]

5. The annex to this Convention applies in a Contracting State which has made a declaration under article 40.

Article 2
Assignment of receivables

For the purposes of this Convention:

(a) "Assignment" means the transfer by agreement from one person ("assignor") to another person ("assignee") of all or part of, or an undivided interest in, the assignor's contractual right to payment of a monetary sum ("receivable") from a third person ("the debtor"). The creation of rights in receivables as security for indebtedness or other obligation is deemed to be a transfer;

(b) In the case of an assignment by the initial or any other assignee ("subsequent assignment"), the person who makes that assignment is the assignor and the person to whom that assignment is made is the assignee.

Article 3
Internationality

A receivable is international if, at the time of the conclusion of the original contract, the assignor and the debtor are located in different States. An assignment is international if, at the time of the conclusion of the contract of assignment, the assignor and the assignee are located in different States.

Article 4
Exclusions

1. This Convention does not apply to assignments:

(a) Made to an individual for his or her personal, family or household purposes;

(b) Made by the delivery of a negotiable instrument, with an endorsement, if necessary;

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

2. This Convention does not apply to assignments of receivables arising under or from:

(a) Transactions on a regulated exchange;

(b) Financial contracts governed by netting agreements, except a receivable owed on the termination of all outstanding transactions;

(c) Bank deposits;

(d) Inter-bank payment systems or inter-bank payment agreements, or investment securities settlement systems;

(e) A letter of credit or independent guarantee;

(f) The sale, loan or holding of, or agreement to repurchase, investment securities.

3. This Convention does not:

(a) Affect whether a property right in real estate confers a right in a receivable related to that real estate or determine the priority of such a right in the receivable with respect to the competing right of an assignee of the receivable;

(b) Make lawful the acquisition of property rights in real estate not permitted under the law of the State where the real estate is situated.

[4. This Convention does not apply to assignments listed in a declaration made under article 39 by the State in which the assignor is located, or with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, by the State in which the debtor is located.]

CHAPTER II

General provisions

Article 5
Definitions and rules of interpretation

For the purposes of this Convention:

(a) "Original contract" means the contract between the assignor and the debtor from which the assigned receivable arises;

(b) "Existing receivable" means a receivable that arises upon or before the conclusion of the contract of assignment; "future receivable" means a receivable that arises after the conclusion of the contract of assignment;

(c) "Writing" means any form of information that is accessible so as to be usable for subsequent reference. Where this Convention requires a writing to be signed, that requirement is met if, by generally accepted means or a procedure agreed to by the person whose signature is required, the writing identifies that person and indicates that person's approval of the information contained in the writing;

(d) "Notification of the assignment" means a communication in writing which reasonably identifies the assigned receivables and the assignee;

(e) "Insolvency administrator" means a person or body, including one appointed on an interim basis, authorized in an insolvency proceeding to administer the reorganization or liquidation of the assignor's assets or affairs;

(f) "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 or other competent authority for the purpose of reorganization or liquidation;

(g) "Priority" means the right of a party in preference to another party;

(h) A person is located in the State in which it has its place of business. If the assignor or the assignee has places of business in more than one State, the place of business is that place where the central administration of the assignor or the assignee is exercised. If the debtor has places of business in more than one State, the place of business is that which has the closest relationship to the original contract. If a person does not have a place of business, reference is to be made to the habitual residence of that person;

(i) "Law" means the law in force in a State other than its rules of private international law;

(j) "Proceeds" means whatever is received in respect of an assigned receivable, whether in total or partial payment or other satisfaction of the receivable. The term includes whatever is received in respect of proceeds. The term does not include returned goods;

(k) "Financial contract" means any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, and any other transaction similar to any transaction referred to above entered into in financial markets and any combination of the transactions mentioned above;

(l) "Netting agreement" means an agreement which provides for one or more of the following:

(i) The net settlement of payments due in the same currency on the same date whether by novation or otherwise;

(ii) Upon the insolvency or other default by a party, the termination of all outstanding transactions at their replacement or fair market values, conversion of such sums into a single currency and netting into a single payment by one party to the other; and

(iii) The set-off of amounts calculated as contemplated by the preceding subparagraph *(l)* (ii) under two or more netting agreements.

Article 6
Party autonomy

Subject to article 21, the assignor, the assignee and the debtor may derogate from or vary by agreement provisions of this Convention relating to their respective rights and obligations. Such an agreement does not affect the rights of any person who is not a party to the agreement.

Article 7
Principles of interpretation

1. In the interpretation of this Convention, regard is to be had to its object and purpose as set forth in the preamble, 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.

CHAPTER III

Effects of assignment

Article 8
Form of assignment

An assignment is valid as to form if it meets the form requirements, if any form requirements exist, of either the law of the State in which the assignor is located or any other law applicable by virtue of the rules of private international law.

Article 9
Effectiveness of bulk assignments, assignments of future receivables and partial assignments

1. An assignment of existing or future, one or more, receivables, and parts of, or undivided interests in, receivables is effective as between the assignor and the assignee, as well as against the debtor, whether the receivables are described:

(a) Individually as receivables to which the assignment relates; or

(b) In any other manner, provided that they can, at the time of the assignment or, in the case of future receivables, at the time of the conclusion of the original contract, be identified as receivables to which the assignment relates.

2. Unless otherwise agreed, an assignment of one or more future receivables is effective without a new act of transfer being required to assign each receivable.

3. Except as provided in paragraph 1 of this article, article 11 and paragraphs 2 and 3 of article 12, this Convention does not affect any limitations on assignment arising from law.

4. An assignment of a receivable is not ineffective against, and the right of an assignee may not be denied priority with respect to the competing rights of, a person described in subparagraph *(a)* of article 24, solely because law other than this Convention does not generally recognize an assignment described in paragraph 1 of this article.

Article 10
Time of assignment

Without prejudice to the rights of a person described in subparagraph *(a)* of article 24, an existing receivable is transferred, and a future receivable is deemed to be transferred, at the time of the conclusion of the contract of assignment, unless the assignor and the assignee have specified a later time.

Article 11
Contractual limitations on assignments

1. An assignment of a receivable is effective notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee 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 for breach of such an agreement, but the other party to that agreement may not avoid the original contract or the assignment contract on the sole ground of that breach. A person who is not party to such an agreement is not liable on the sole ground that it had knowledge of the agreement.

3. This article applies only to assignments of receivables:

(a) Arising under an original contract for the supply or lease of [goods], construction or services other than financial services, or for the sale or lease of real estate;

(b) Arising under an original contract for the sale, lease or licence of industrial or other intellectual property or other information;

(c) Representing the payment obligation for a credit card transaction; or

(d) Owed to the assignor upon net settlement of payments due pursuant to a netting agreement involving more than two parties.

Article 12
Transfer of security rights

1. A personal or property right securing payment of the assigned receivable is transferred to the assignee without a new act of transfer. If such a right, under the law governing it, is transferable only with a new act of transfer, the assignor is obliged to transfer this right and any proceeds to the assignee.

2. A right securing payment of the assigned receivable is transferred under paragraph 1 of this article notwithstanding an agreement between the assignor and the debtor or other person granting the right, limiting in any way the assignor's right to assign the receivable or the right securing payment of the assigned receivable.

3. Nothing in this article affects any obligation or liability of the assignor for breach of an agreement under paragraph 2 of this article, but the other party to that agreement may not avoid the original contract or the assignment contract on the sole ground of that breach. A person who is not a party to such an agreement is not liable on the sole ground that it had knowledge of the agreement.

4. Paragraphs 2 and 3 of this article apply only to assignments of receivables:

(a) Arising under an original contract for the supply or lease of [goods], construction or services other than financial services, or for the sale or lease of real estate;

(b) Arising under an original contract for the sale, lease or licence of industrial or other intellectual property or other information;

(c) Representing the payment obligation for a credit card transaction; or

(d) Owed to the assignor upon net settlement of payments due pursuant to a netting agreement involving more than two parties.

5. 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.

6. 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 receivable.

CHAPTER IV

Rights, obligations and defences

Section I
Assignor and assignee

Article 13
Rights and obligations of the assignor and the assignee

1. The rights and obligations of the assignor and the assignee as between them 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 implicitly made applicable to the assignment a usage that in international trade is widely known to, and regularly observed by, parties to the particular practice.

Article 14
Representations of the assignor

1. Unless otherwise agreed between the assignor and the assignee, the assignor represents at the time of the conclusion 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 15
Right to notify the debtor

1. Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor a notification of the assignment and a payment instruction, but after notification is sent only the assignee may send a payment instruction.

2. A notification of the assignment or payment instruction sent in breach of any agreement referred to in paragraph 1 of this article is not ineffective for the purposes of article 19 by reason of such breach. 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.

Article 16
Right to payment

1. As between the assignor and the assignee, unless otherwise agreed, and whether or not a notification of the assignment has been sent:

(a) If payment in respect of the assigned receivable is made to the assignee, the assignee is entitled to retain the proceeds and goods returned in respect of the assigned receivable;

(b) If payment in respect of the assigned receivable is made to the assignor, the assignee is entitled to payment of the proceeds and is also entitled to goods returned to the assignor in respect of the assigned receivable; and

(c) If payment in respect of the assigned receivable is made to another person over whom the assignee has priority, the assignee is entitled to payment of the proceeds and is also entitled to goods returned to such person in respect of the assigned receivable.

2. The assignee may not retain more than the value of its right in the receivable.

Section II
Debtor

Article 17
Principle of debtor protection

1. Except as otherwise provided in this Convention, an assignment does not, without the consent of the debtor, affect the rights and obligations of the debtor, including the payment terms contained in the original contract.

2. A payment instruction may change the person, address or account to which the debtor is required to make payment, but may not:

(a) Change the currency of payment specified in the original contract; or

(b) Change the State specified in the original contract, in which payment is to be made, to a State other than that in which the debtor is located.

APPENDIX

RENUMBERING OF ARTICLES OF THE DRAFT CONVENTION

Current article number (annex I to the present document)	*Former article number (A/CN.9/466, annex I)*
1	1
2	2
3	3
4	4
5	6
6	7
7	8
8	New article
9	9
10	10
11	11
12	12
13	13
14	14
15	15
16	16
17	17

ANNEX II

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

[Annex II is reproduced in part three, III of this *Yearbook*]

B. United Nations Conference on Trade and Development (UNCTAD): extract from the report of the Trade and Development Board (forty-seventh session) (TD/B/47/11 (Vol. I)

I. F. 2 Progressive development of the law of international trade: thirty-third annual report of the United Nations Commission on International Trade Law

2. At its 917th plenary meeting, on 20 October 2000, the Board took note of the report of UNCITRAL on its thirty-third session (A/55/17).

C. General Assembly: report of the United Nations Commission on International Trade Law on the work of its thirty-third session: report of the Sixth Committee (A/55/608)

I. INTRODUCTION

1. At its 9th plenary meeting, on 11 September 2000, the General Assembly, on the recommendation of the General Committee, decided to include in the agenda of its fifty-fifth session the item entitled "Report of the United Nations Commission on International Trade Law on the work of its thirty-third session" and to allocate it to the Sixth Committee.

2. The Sixth Committee considered the item at its 3rd, 4th, 24th and 25th meetings, on 9 and 10 October and on 3 and 8 November 2000. The views of the representatives who spoke during the Committee's consideration of the item are reflected in the relevant summary records (A/C.6/55/SR.3, 4, 24 and 25).

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-third session.[1]

4. At the 3rd meeting, on 9 October, the Chairman of the United Nations Commission on International Trade Law at its thirty-third session introduced the report of the Commission on the work of that session (see A/C.6/55/SR.3).

5. At the 4th meeting, on 10 October, the Chairman of the Commission made a statement in the light of the debate (see A/C.6/55/SR.4).

[1] *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17* (A/55/17).

II. CONSIDERATION OF DRAFT RESOLUTION A/C.6/55/L.5

6. At the 24th meeting, on 3 November, the representative of Austria, on behalf of *Algeria, Angola, Argentina, Armenia, Australia, Austria, Azerbaijan, Bahrain, Belgium, Bosnia and Herzegovina, Brazil, Bulgaria, Canada, Chile, China, Colombia, Costa Rica, Croatia, Cyprus, the Czech Republic, Denmark, Ecuador, Egypt, Finland, France, Germany, Greece, Guatemala, Haiti, Hungary, India, Indonesia, the Islamic Republic of Iran, Ireland, Israel, Italy, Japan, Lesotho, Liechtenstein, Lithuania, Luxembourg, Madagascar, Malta, Mexico, the Netherlands, New Zealand, Nigeria, Norway, Peru, the Philippines, Poland, Portugal, Romania, the Russian Federation, Rwanda, San Marino, Singapore, Slovakia, Slovenia, South Africa, Spain, Sweden, Thailand, the former Yugoslav Republic of Macedonia, Turkey, Uganda, Ukraine, the United Kingdom of Great Britain and Northern Ireland, Uruguay* and *Venezuela*, subsequently joined by *Belarus, Bolivia, Botswana* and *Saudi Arabia*, introduced a draft resolution entitled "Report of the United Nations Commission on International Trade Law on the work of its thirty-third session" (A/C.6/55/L.5).

7. At its 25th meeting, on 8 November, the Committee adopted draft resolution A/C.6/55/L.5 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 55/151 (see section D below).]

D. General Assembly resolution 55/151 of 12 December 2000

RESOLUTION ADOPTED
BY THE GENERAL ASSEMBLY

[on the report of the Sixth Committee (A/55/608)]

55/151. *Report of the United Nations Commission on International Trade Law on the work of its thirty-third 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 contribute significantly to universal economic cooperation among all States on a basis of equality, equity and common interest and to the elimination of discrimination in international trade and, thereby, to the well-being of all peoples,

Emphasizing the need for higher priority to be given to the work of the Commission in view of the increasing value of the modernization of international trade law for global economic development and thus for the maintenance of friendly relations among States,

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-third session,[1]

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 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-third session;[2]

2. *Commends* the Commission for the work on privately financed infrastructure projects, which culminated in the adoption of the UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects,[3] as well as the important progress made in its work on receivables financing;

3. *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 and, in particular, to the legislative implementation of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, done at New York on 10 June 1958;[4]

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

5. *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;

6. *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;

7. *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 Brazil, Cameroon, Côte d'Ivoire, Madagascar, Peru, the Russian Federation and South Africa;

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

[1] *Official Records of the General Assembly, Fifty-fifth Session, Supplement No. 17* (A/55/17).

[2] Ibid.

[3] Ibid., para. 372.

[4] United Nations, *Treaty Series*, vol. 330, No. 4739.

8. *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;

9. *Appeals* to Governments, the relevant bodies of the United Nations system, 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;

10. *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-fifth 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;

11. *Requests* the Secretary-General to strengthen the secretariat of the Commission within the bounds of the resources available so as to ensure and enhance the effective implementation of the programme of the Commission;

12. *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;

13. *Requests* the Secretary-General to submit to the General Assembly at its fifty-sixth session a report on the implications of increasing the membership of the Commission, and invites Member States to submit their views on this issue;

14. *Expresses its appreciation* to Gerold Herrmann, Secretary of the United Nations Commission on International Trade Law since 1991, who will retire on 31 January 2001, for his outstanding and devoted contribution to the process of unification and harmonization of international trade law in general and to the Commission in particular.

84th plenary meeting
12 December 2000

Part Two

STUDIES AND REPORTS ON SPECIFIC SUBJECTS

A/CN.9/471

I. PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a *Legislative Guide on Privately Financed Infrastructure Projects*: Report of the Secretary-General

(A/CN.9/471 and Add.1-9) [Original: English]

I. INTRODUCTION

1. At its twenty-ninth session, in 1996, having considered a note by the secretariat on "build-operate-transfer" (BOT) projects (A/CN.9/424), the United Nations Commission on International Trade Law decided to prepare a legislative *Guide* to assist States in preparing or modernizing legislation relevant to those projects.[1] The Commission requested the secretariat to review issues suitable for treatment in such a legislative *Guide* and to prepare draft materials for consideration by the Commission.

2. At its thirtieth session, in 1997, the Commission considered an annotated table of contents setting out the topics proposed for inclusion in the legislative *Guide* (A/CN.9/438, annex). The Commission also considered initial drafts of chapters I, "Scope, purpose and terminology of the *Guide*", II, "Parties and phases of privately financed infrastructure projects", and V, "Preparatory measures" (A/CN.9/438/Add.1-3, respectively), of the *Guide*. After an exchange of views on the nature of the issues to be discussed and possible methods for addressing them in the *Guide*, the Commission generally approved the line of work proposed by the secretariat, as contained in those documents.[2] The Commission requested the secretariat to seek the assistance of outside experts, as required, in the preparation of future chapters and invited Governments to identify experts who could be of assistance to the secretariat in that task.

3. At its thirty-first session, in 1998, the Commission had before it revised versions of the earlier chapters, including a revised table of contents, a draft of the introduction to the legislative *Guide*, initial drafts 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). The Commission considered various specific suggestions concerning the draft chapters, as well as proposals for changing the structure of the legislative *Guide* and reducing the number of chapters.[3] The Commission requested the secretariat to continue the preparation of future chapters, with the assistance of outside experts, for submission to the Commission at its thirty-second session.

4. At its thirty-second session, in 1999, the Commission considered a complete draft of the legislative *Guide*, which consisted of the following: "Introduction and background information on privately financed infrastructure projects", and chapters I, "General legislative considerations", II, "Project risks and government support", III, "Selection of the concessionaire", IV, "The project agreement", V, "Infrastructure development and operation", VI, "End of project term, extension and termination", VII, "Governing law", and VIII, "Settlement of disputes" (A/CN.9/458/Add.1-9, respectively). The Commission was informed that the secretariat had changed the overall structure of the legislative *Guide* and combined some of its chapters. The Commission noted and generally approved the revised structure of the draft legislative *Guide*.[4] The Commission considered various specific suggestions concerning the draft chapters.[5]

II. STRUCTURE AND CONTENTS OF THE DRAFT LEGISLATIVE *GUIDE*

5. At the Commission's thirty-second session, in 1999, it was observed that it was the first occasion on which the draft *Guide* was available in its entirety. While it was generally felt that the draft chapters covered most of the central issues pertaining to privately financed infrastructure projects, the view was expressed that the document was rather lengthy and that adjustments were necessary in order to make the *Guide* more accessible to the intended readers.[6]

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

[2] Ibid., *Fifty-second Session, Supplement No. 17* (A/52/17), paras. 231-247.

[3] Ibid., *Fifty-third Session, Supplement No. 17* (A/53/17), paras. 12-206.

[4] Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), para. 18.

[5] Ibid., paras. 17-307.

[6] Ibid., para. 18.

Therefore, while revising the draft chapters so as to reflect suggestions made at the thirty-second session of the Commission, the secretariat has endeavoured to make the notes as concise as possible, taking into account the broad scope of the *Guide* and the wide variety of issues raised by privately financed infrastructure projects.

Introduction and background information on privately financed infrastructure projects

6. An earlier draft of the introduction was contained in document A/CN.9/458/Add.1. A revised draft, which takes into account suggestions made at the thirty-second session of the Commission,[7] is contained in an addendum to the present document (A/CN.9/471/Add.1).

Chapter I. General legislative and institutional framework

7. An earlier draft of chapter I was contained in document A/CN.9/458/Add.2. A revised draft, which takes into account suggestions made at the thirty-second session of the Commission,[8] is contained in an addendum to the present document (A/CN.9/471/Add.2).

Chapter II. Project risks and government support

8. An initial draft of chapter II was contained in document A/CN.9/458/Add.3. A revised draft, which takes into account suggestions made at the thirty-second session of the Commission,[9] is contained in an addendum to the present document (A/CN.9/471/Add.3).

Chapter III. Selection of the concessionaire

9. An earlier version of this chapter was contained in document A/CN.9/458/Add.4. A revised draft, which takes into account suggestions made at the thirty-second session of the Commission,[10] is contained in an addendum to the present document (A/CN.9/471/Add.4).

Chapter IV. Construction and operation of infrastructure

10. The draft chapter combines issues previously proposed for discussion in two separate chapters, namely, chapters IV, "The project agreement" (contained in A/CN.9/458/Add.5), and V, "Infrastructure development and operation" (also contained in A/CN.9/458/Add.6). A consolidated revised draft, which takes into account suggestions made at the thirty-second session of the Commission,[11] is contained in an addendum to the present document (A/CN.9/471/Add.5).

Chapter V. Duration, extension and termination of the project agreement

11. An earlier version of this chapter (previously numbered chapter VI) was contained in document A/CN.9/458/Add.7. A revised draft, which takes into account suggestions made at the thirty-second session of the Commission,[12] is contained in an addendum to the present document (A/CN.9/471/Add.6).

Chapter VI. Settlement of disputes

12. An earlier version of this chapter (previously numbered chapter VIII) was contained in document A/CN.9/458/Add.9. A revised draft, which takes into account suggestions made at the thirty-second session of the Commission,[13] is contained in an addendum to the present document (A/CN.9/471/Add.7).

Chapter VII. Other relevant areas of law

13. An earlier version of this chapter was contained in document A/CN.9/458/Add.8. A revised draft, which takes into account suggestions made at the thirty-second session of the Commission,[14] is contained in an addendum to the present document (A/CN.9/471/Add.8).

Consolidated legislative recommendations

14. At the thirty-second session of the Commission it was agreed that the legislative recommendations contained in each chapter needed to be reformulated for greater uniformity.[15] With the assistance of experts, the secretariat has since reviewed the recommendations in their entirety, so as to ensure their coherence and consistency with one another. In order to facilitate the Commission's deliberations, all recommendations contained in the individual chapters have been consolidated into an addendum to the present document (A/CN.9/471/Add.9). The Commission may wish to consider the desirability of including such a consolidation of the recommendations in the final presentation of the *Guide* for the users' ease of reference.

III. CONCLUSION

15. The Commission may wish to consider that, given the advanced stage of preparation of the draft legislative *Guide*, two days of its upcoming session would be sufficient for a final review of the legislative recommendations and adoption of the *Guide*.

[7] Ibid., paras. 22-38.
[8] Ibid., paras. 39-69.
[9] Ibid., paras. 70-96.
[10] Ibid., paras. 97-136.
[11] Ibid., paras. 137-205.
[12] Ibid., paras. 206-253.
[13] Ibid., paras. 287-307.
[14] Ibid., paras. 254-282.
[15] Ibid., para. 21.

A/CN.9/471/Add.1

Introduction and background information on privately financed infrastructure projects*

CONTENTS

A. INTRODUCTION

1. 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 and 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 out at that time and there was a rapid development of international project financing, including international bond offerings to finance railways or other major infrastructure.

2. However, during most of the twentieth century the international trend was, in turn, towards 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 in infrastructure service provision became enshrined in the constitution.

3. The current reverse trend towards private sector participation and competition in infrastructure sectors started in the early 1980s and 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; the expansion of international and local capital markets, with a consequent improvement in access to private funding; and an increasing number of successful international experiences with private participation and competition in infrastructure. In many countries, new legislation was adopted, not only to govern such transactions, but also to modify the market structure and the rules of competition governing the sectors in which they were taking place.

4. The purpose of the present *Guide* is to assist in the establishment of a legal framework favourable to private investment in public infrastructure. The advice provided in the *Guide* aims at achieving a balance between the desire to facilitate and encourage private participation in infrastructure projects, on the one hand, and various public interest concerns of the host country, on the other. The *Guide* discusses a number of concerns of fundamental public interest, which, despite numerous differences of policy and legislative treatment, are recognized in most legal systems. Points of public concern include matters such as continuity in the provision of public services; adherence to environmental protection, health, safety and quality standards set by the host country; fairness of prices charged to the public; non-discriminatory treatment of customers or users, full disclo-

*Section B of the present chapter is 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 *Guidelines for Infrastructure Development through Build-Operate-Transfer (BOT) Projects*, prepared by the United Nations Industrial Development Organization (UNIDO Publication, Sales No. UNIDO.95.6.E), the *World Development Report 1994: Infrastructure for Development* (New York, Oxford University Press, 1994) and the *World Development Report 1996: From Plan to Market* (New York, Oxford University Press, 1996), both published by the World Bank, or *Financing Private Infrastructure* (Washington, D.C., 1996), published by the International Finance Corporation.

sure of information pertaining to the operation of infrastructure facilities and the flexibility needed to meet changed conditions, including expansion of the service to meet additional demand. Fundamental concerns of the private sector, in turn, usually include issues such as stability of the legal and economic environment in the host country; transparency of laws and regulations and predictability and impartiality in their application; enforceability of property rights against violations by third parties; assurances that private property is respected by the host country and not interfered with other than for reasons of public interest and only if compensation is paid; and freedom of the parties to agree on commercial terms that ensure a reasonable return on invested capital commensurate with the risks taken by private investors. The *Guide* does not provide a single set of model solutions to address these concerns, but it helps the reader to evaluate different approaches available and to choose the one most suitable in the national or local context.

1. Organization and scope of the *Guide*

5. Each chapter of the *Guide* contains a set of recommended legislative principles entitled "legislative recommendations". The legislative recommendations are intended to assist in the establishment of a legislative framework favourable to privately financed infrastructure projects. The legislative recommendations contained in the *Guide* are followed by notes offering an analytical introduction with references to financial, regulatory, legal, policy and other issues raised in the subject area. The user is advised to read the legislative recommendations together with the notes, which provide background information to enhance the understanding of the legislative recommendations.

6. The legislative recommendations deal with matters that are important to address in legislation specifically concerned with privately financed infrastructure projects. They do not deal with other areas of law, which, as discussed in notes to the legislative recommendations, also have an impact on privately financed infrastructure projects. Moreover, the successful implementation of privately financed infrastructure projects typically requires various measures beyond the establishment of an appropriate legislative framework, such as adequate administrative structures and practices, organizational capability, technical expertise, appropriate human and financial resources and economic stability. Although some of these matters are mentioned in the notes, they are not addressed in the legislative recommendations.

7. The *Guide* is intended to be used as a reference by national authorities and legislative bodies when preparing new laws or reviewing the adequacy of existing laws and regulations. For that purpose, the *Guide* helps identify areas of law that are typically most relevant to private capital investment in public infrastructure projects and discusses the content of those laws which would be conducive to attracting private capital, national and foreign. The *Guide* is not intended to provide advice on drafting agreements for the execution of privately financed infrastructure projects. However, the *Guide* discusses some contractual issues (for instance, in chaps. IV, "Construction and operation of infrastructure" and V, "Duration, extension and termination of the project agreement") to the extent that they relate to matters that might usefully be addressed in the legislation.

8. The *Guide* pays special attention to infrastructure projects that involve an obligation, on the part of the selected investors, to undertake physical construction, repair or expansion works in exchange for the right to charge a price, either to the public or to a public authority, for the use of the infrastructure facility or for the services it generates. Although such projects are sometimes grouped with other transactions for the "privatization" of governmental functions or property, the *Guide* is not concerned with "privatization" transactions that do not relate to the development and operation of public infrastructure. In addition, the *Guide* does not address projects for the exploitation of natural resources, such as mining, oil or gas exploitation projects under some "concession", "licence" or "permission" issued by the public authorities of the host country.

2. Terminology used in the *Guide*

9. The following paragraphs explain the meaning and use of certain expressions that appear frequently in the *Guide*. For terms not mentioned below, such as technical terms used in financial and business management writings, the reader is advised to consult other sources of information on the subject, such as the *Guidelines for Infrastructure Development through Build-Operate-Transfer (BOT) Projects* prepared by the United Nations Industrial Development Organization (UNIDO).[1]

(a) "Public infrastructure" and "public services"

10. As used in the *Guide*, the expression "public infrastructure" refers to physical facilities that provide services essential to the general public. Examples of public infrastructure in this sense may be found in various sectors and include various types of facility, equipment or system: power generation plants and power distribution networks (electricity sector); systems for local and long-distance telephone communications and data transmission networks (telecommunications sector); desalination plants, waste water treatment plants, water distribution facilities (water sector); facilities and equipment for waste collection and disposal (sanitation sector); and physical installations and systems used for public transportation, such as urban and inter-urban railways, underground trains, bus lines, roads, bridges, tunnels, ports, airlines and airports (transportation sector).

11. The line between "public" and "private" infrastructure must be drawn by each country as a matter of public policy. In some countries, airports are owned by the Government; in others they are privately owned but subject to regulation or to the terms of an agreement with the competent public authority. Hospital and medical facilities and prison and correctional facilities may be regarded as "public" or "private" infrastructure, depending on the country's preferences. Often, but not always, power and telecommu-

[1]UNIDO publication, Sales No. UNIDO.95.6.E, hereafter referred to as the *UNIDO BOT Guidelines.*

nication facilities are regarded as "public" infrastructure. No view is expressed in the *Guide* as to where the line should be drawn in a particular country.

12. The notions of "public infrastructure" and "public services" are well established in the legal tradition of some countries, being sometimes governed by a specific body of law, which is typically referred to as "administrative law" (see chap. VII, "Other relevant areas of law", ___). However, in a number of other countries, apart from being subject to special regulations, public services are not regarded as being intrinsically distinct from other types of business. As used in the *Guide*, the expressions "public services" and "public service providers" should not be understood in a technical sense that may be attached to them under any particular legal system.

(b) "Concession", "project agreement" and related expressions

13. In many countries, public services constitute government monopolies or are otherwise subject to special regulation. Where that is the case, the provision of a public service by an entity other than a public authority typically requires an act of authorization by the appropriate governmental body. Different expressions are used to define such acts of authorization under national laws and in some legal systems various expressions may be used to denote different types of authorizations. Commonly used expressions include terms such as "concession", "franchise", "licence" or "lease" ("*affermage*"). In some legal systems, in particular 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". As used in the *Guide*, the word "concession" is not to be understood in a technical sense that may be attached to it under any particular legal system or domestic law.

14. As used in the *Guide*, the term "project agreement" means an agreement between a public authority and the entity or entities selected by that public authority to carry out the project that sets forth the terms and conditions for the construction or modernization, operation and maintenance of the infrastructure. Other expressions that may be used in some legal systems to refer to such an agreement, such as "concession agreement" or "concession contract", are not used in the *Guide*.

15. The *Guide* uses the word "concessionaire" to refer generally to an entity that carries out public infrastructure projects under a concession issued by the public authorities of the host country. The term "project company" is sometimes used in the *Guide* to refer specifically to an independent legal entity established for the purpose of carrying out a particular project.

(c) References to national authorities

16. As used in the *Guide*, the word "Government" encompasses the various public authorities of the host country entrusted with executive or policy-making functions, at the national, provincial or local level. The expression "public authorities" is used to refer, in particular, to entities of, or related to, the executive branch of the Government. The expression "legislature" is used specifically with reference to the organs that exercise legislative functions in the host country.

17. The expression "contracting authority" is generally used in the *Guide* to refer to the public authority of the host country 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 (see below, paras. 69 and 70).

18. The expression "regulatory agency" is used in the *Guide* to refer to the public authority that is entrusted with the power to issue and enforce rules and regulations governing the operation of the infrastructure. The regulatory agency may be established by statute with the specific purpose of regulating a particular infrastructure sector.

(d) "Build-operate-transfer" and related expressions

19. The various types of projects referred to in this *Guide* as privately financed infrastructure projects are sometimes divided into several categories, according to the type of private participation or the ownership of the relevant infrastructure, as indicated below:

(a) Build-operate-transfer (BOT). An infrastructure project is said to be a BOT project when the contracting authority selects a concessionaire 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 facility is transferred to the contracting authority;

(b) Build-transfer-operate (BTO). This expression is sometimes used to emphasize that the infrastructure facility becomes the property of the contracting authority immediately upon its completion, the concessionaire being awarded the right to operate the facility for a certain period;

(c) Build-rent-operate-transfer (BROT) or *"build-lease-operate-transfer" (BLOT).* These are variations of BOT or BTO projects where, in addition to the obligations and other terms usual to BOT projects, the concessionaire rents the physical assets on which the facility is located for the duration of the agreement;

(d) Build-own-operate-transfer (BOOT). These are projects in which a concessionaire 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. Under this arrangement the private entity owns the facility and its assets until it is transferred to the contracting authority;

(e) Build-own-operate (BOO). This expression refers to projects where the concessionaire owns the facility permanently and is not under an obligation to transfer it back to the contracting authority.

20. Besides acronyms used to highlight the particular ownership regime, other acronyms may be used to emphasize one or more of the obligations of the concessionaire. 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 may be 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. The expression "design-build-finance-operate" (DBFO) is sometimes used to emphasize the concessionaire's additional responsibility for designing the facility and financing its construction.

B. BACKGROUND INFORMATION ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

21. In most of the countries that have recently built new infrastructure through private investment, privately financed infrastructure projects are an important tool in meeting national infrastructure needs. 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. 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.

22. In devising programmes to promote private sector investment in the development and operation of public infrastructure, a number of countries have found it useful to review the assumptions under which public sector monopolies were established, including the historical circumstances and political conditions that had led to their creation, with a view to *(a)* identifying those activities which still maintain the characteristics of natural monopoly; and *(b)* assessing the feasibility and desirability of introducing competition in certain infrastructure sectors.

1. Private investment and infrastructure policy

23. The measures that may be required to implement a governmental policy to promote competition in various infrastructure sectors will depend essentially on the prevailing market structure. The main elements that characterize a particular market structure include barriers to the entry of competitors of an economic, legal, technical or other nature, 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.

(a) Competition policy and monopolies

24. 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. These are 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 upfront fixed investment requirements that make it difficult for a new company, lacking comparable economies of scale, to enter the market and undercut the incumbent;

(b) Legal monopolies. Legal monopolies are established by law and may cover sectors or activities that are or are not natural monopolies. 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) De facto monopolies. These monopolies may not necessarily be the result of economic fundamentals or of legal provisions, but simply of 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.

25. Although monopolies are sometimes justified by legal, political or social grounds, they may produce negative economic effects. A service provider operating under monopolistic conditions is typically able to fix prices above those which would be charged in competitive conditions. The surplus profit that results from insufficient competition implies a transfer of wealth from consumers to producers. Monopolies have also been found to cause a net loss of welfare to the economy as a result of inflated prices generated by artificially low production; a reduced rate of innovation; and insufficient efforts to reduce production costs. Furthermore, in particular in infrastructure sectors, there may be secondary effects on other markets. (For example, lack of competition and efficiency in telecommunications has negative repercussions through increases in cost for the economy at large.)

26. Despite their negative economic effects, monopolies and other regulatory barriers to competition 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. schoolchildren or 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.

27. 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, that objective has to be balanced against the interests of consumers and the economy as a whole. 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, though on a temporary basis only (see chap. I, "General legislative and institutional framework", paras. 20-22).

(b) Scope for competition in different sectors

28. 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 broadened the potential scope for competition in infrastructure sectors, as discussed briefly below:

(a) Telecommunication sector. New wireless technology not only makes mobile telecommunication services possible, but it 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, telecommunication services have become competitive and countries are increasingly opening up the sector to free entry, while limiting access only to services that require the use of scarce public resources, such as radio frequency;

(b) Energy sector. 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;

(c) Transport sector. 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, making it possible to track shipments across the globe, have had profound consequences on shipping, port management and rail and truck transport, while fostering the development of intermodal transport.

29. Technological changes such as these have prompted the legislatures 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.

2. Restructuring of infrastructure sectors

30. In many countries, private participation in infrastructure development has followed the introduction of measures to restructure infrastructure sectors. 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 that cannot be justified by reasons of public interest. It should be noted, however, that the extent to which a particular sector may be opened to competition is a decision that is taken in the light of the country's overall economic policy. Some countries, in particular developing countries, might have a legitimate interest in promoting the development of certain sectors of local industry and might thus choose not to open certain infrastructure sectors to competition.

31. For monopolistic situations resulting from legal prohibitions rather than economic and technological fundamentals, the main legislative action needed to introduce competition is the removal of the existing legal barriers. This may need to be reinforced by rules of competition (such as the prohibition of collusion, cartels, predatory pricing or other unfair trading practices) and regulatory oversight (see chap. I, "General legislative and institutional framework", paras. 30-53). For a number of activities, however, effective competition may not be obtained through the mere removal of legislative 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.

(a) Unbundling of infrastructure services

32. In the experience of some countries it has been found that 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 market segments in order to extract monopoly rents in those activities as well. Therefore, some countries have found it necessary to separate the monopoly element (such as the grid in many networks) from competitive elements in given infrastructure sectors. By and large, infrastructure services tend to be competitive, whereas the underlying physical infrastructure often has monopolistic characteristics.

33. The separation of competitive activities from monopolistic ones may in turn require the unbundling of vertically or horizontally integrated activities. 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. 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 produc-

tion) 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).

34. However, the costs and benefits of such changes need to be considered carefully. Costs may include the costs associated with the change itself (e.g. transaction and transition costs, including the loss incurred by companies that lose benefits or protected positions as a result of the new scheme) and those resulting from the operation of the new scheme, in particular higher coordination costs resulting, for example, from more complicated network planning, technical standardization or regulation. Benefits, on the other hand, may include new investments, better or new services, more choice and lower economic costs.

(b) Recent experience in major infrastructure sectors

(i) Telecommunications

35. Unbundling has not been too common in the telecommunication 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 those countries that trend is now being reversed, with local telephone companies 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 telecommunication sector of those countries where the historical public service provider offers services in competition with other providers while controlling essential parts of the network.

(ii) Electricity

36. Electricity laws recently enacted in various countries 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 those 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 the countries concerned, competition is limited to large users only or is being phased in gradually.

37. 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 agencies, have been established to make the 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

38. 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 only slightly interconnected. In practice, it has been found that horizontal unbundling facilitates comparison of the performance of service providers.

39. 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 such 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. 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.

(iv) Transport

40. In the restructuring measures taken in various countries, a 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, since trains, trucks, buses, airlines and ships tend to compete for passengers and freight.

41. With respect to railways, some countries have opted for a separation between the ownership and operation of infrastructure (e.g. tracks, signalling systems and train stations) on the one hand and of rail transport services (e.g. passenger and freight) on the other. In such schemes, the law does not allow the track operator also to operate 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 those cases, transport companies, whether another rail line or a transport service company, have right of access to the track on certain terms and the company controlling the track has the obligation to grant such access.

42. In many countries, ports were until recently managed as public sector monopolies. When opening the 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 and warehousing) may be easier to establish and maintain under the landlord system.

43. Legislation governing airports may also require changes, whether to allow private investment or competition between or within airports. Links between airport operation and air traffic control may also need to be considered carefully. Within airports, many countries have introduced competition in handling services, catering and other services to planes, as well as in 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, thus creating competition between terminals. In others, new airports have been built on a BOT basis and existing ones transferred to private ownership.

(c) Transitional measures

44. The transition from monopoly to market needs 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 those changing circumstances into account.

45. 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. Those measures are designed to give the incumbent adequate time to prepare for competition and to adjust prices, while providing the public service provider adequate incentives for investment and service expansion. Other countries have included provisions calling for the periodic revision (at the time of price 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.

46. Another transitional measure, at least in some countries with government-owned public service providers, has been the restructuring or privatization of the incumbent service provider. In most countries where government-owned providers of public services have been privatized, 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 public service providers.

3. Forms of private sector participation in infrastructure projects

47. 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 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 facilities may be developed and operated. In a particular sector more than one option may be used.

(a) Public ownership and public operation

48. In cases where public ownership and control is desired, direct private financing as well as infrastructure operation under commercial principles may be achieved by establishing a separate legal entity controlled by the Government to own and operate the project. Such an entity may be 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 infrastructure facilities through these types of company. Opening the capital of such companies to private investment or making use of such a company's ability to issue bonds or other securities may create an opportunity for attracting private investment in infrastructure.

49. Another form of involving private participation in publicly owned and operated infrastructure may be the negotiation of "service contracts" whereby the public operator contracts out specific operation and maintenance activities to the private sector. The Government may also entrust a broad range of operation and maintenance activities to a private entity acting on behalf of the contracting authority. Under such an 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 compensation on the basis of a fixed fee may also be used, in particular where the parties find it difficult to establish mutually acceptable mechanisms to assess the operator's performance.

(b) Public ownership and private operation

50. Alternatively, the whole operation of public infrastructure facilities 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 facility, to supply the relevant services and to collect the revenue generated by that activity. Such a facility may already be in existence or may have been specially built by the private entity concerned. This combination of public ownership and private operation has the essential features of arrangements that in some legal systems may be referred to as "public works concessions" or "public service concessions".

51. Another form of private participation in infrastructure is where a private entity is selected by the contracting au-

thority to operate a facility that has been built by or on behalf of the 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 contracting authority a portion of the revenue generated by the infrastructure that is used by the contracting authority to amortize the construction cost. Such arrangements are referred to in some legal systems as "lease" or *"affermage"*.

(c) Private ownership and operation

52. Under the third approach, the private entity not only operates the facility, but also owns the assets related to it. Here, too, there may be substantial differences in the treatment of those projects under domestic laws, for instance as to whether the contracting authority retains the right to reclaim title to the facility or to assume responsibility for its operation (see also chap. IV, "Construction and operation of infrastructure", paras. 23-29).

53. Where the facility is operated pursuant to a governmental licence, private ownership of physical assets (e.g. a 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 competent public authority under certain circumstances. Thus, private ownership of the facility may not necessarily entail an indefinite right to provide the service.

4. Financing structures and sources of finance for infrastructure

(a) Notion of project finance

54. Large-scale projects involving the construction of new infrastructure facilities are often carried out by new corporate entities specially established for that purpose by the project promoters. Such a new entity, often called a "project company", becomes the vehicle for raising funds for the project. Because the project company lacks an established credit or an established balance sheet on which the lenders can rely, the preferred financing modality for the development of new infrastructure is called "project finance". In a project finance transaction, credit will be made available to the extent that the lenders can be satisfied to look primarily to the project's cash flow and earnings as the source of funds for the repayment of loans taken out by the project company. Other guarantees either are 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.

55. Project finance is also said to be "non-recourse" financing owing to the absence of recourse to the project company's shareholders. In practice, however, lenders are seldom ready to commit the large amounts needed for infrastructure 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 Government, purchasers or other interested third parties. This modality is commonly called "limited recourse" financing.

(b) Financing sources for infrastructure projects

56. Alternatives to traditional public financing are playing an increasing role in the development of infrastructure. In recent years, new infrastructure investment in various countries has included projects with exclusively or predominantly private funding sources. The two main types of fund are debt finance, usually in the form of loans obtained on 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".

(i) Equity capital

57. 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 project promoters or other individual investors interested in taking stock in the concessionaire. 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 project promoters 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 project promoters 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 project promoters is typically welcomed by the lenders and the Government, as it helps reduce the burden of debt service on the concessionaire's cash flow and serves as an assurance of those companies' commitment to the project.

(ii) Commercial loans

58. Debt capital often represents the main source of funding for infrastructure projects. It is obtained on the financial market primarily by means of loans extended to the project company by national or foreign commercial banks, typically using funds that 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 normally have 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 concessionaire over a long period to interest rate fluctuations, while also reducing the need for hedging operations. Commercial loans are usually provided

by lenders on 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.

(iii) "Subordinated" debt

59. The third type of fund typically used in these projects are "subordinated" loans, sometimes also called "mezzanine" capital. Such 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 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 concessionaire at preferential prices.

(iv) Institutional investors

60. In addition to subordinated loans provided by the project promoters or by public financial institutions, subordinated debt may be obtained from financing companies, investment funds, insurance companies, collective investment schemes (e.g. mutual funds), pension funds and other so-called "institutional investors". 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 reasons for accepting the risk of providing capital to infrastructure projects are the prospect of remuneration and interest in diversifying investment.

(v) Capital market funding

61. As more experience is gained with privately financed infrastructure projects, increased use is being made of capital market funding. Funds may be raised by the placement of preferred shares, bonds and other negotiable instruments on a recognized stock exchange. Typically, the public offer of negotiable instruments requires regulatory approval and compliance with 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.

62. 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 have some established record over a certain minimum period before being permitted to issue negotiable instruments.

(vi) Financing by Islamic financial institutions

63. 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 or strict limits to the right to charge interest 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 than other commercial banks to consider direct or indirect equity participation in a project.

(vii) Financing by international financial institutions

64. 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.

65. International financial institutions may also play an instrumental role 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 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 based on 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. Lastly, international financial institutions may provide guarantees against a variety of political risks, which may facilitate the project company's task of raising funds in the international financial market (see chap. II, "Project risks and government support", paras. 61-71).

(viii) Support by export credit and investment promotion agencies

66. Export credit and investment promotion agencies may provide support to the project in the form of loans, guarantees or a combination of both. The participation of export credit and investment promotion agencies may provide a number of advantages, such as lower interest rates than those applied by commercial banks and longer-term loans, sometimes at a fixed interest rate (see chap. II, "Project risks and government support", paras. 72-74).

(ix) Combined public and private finance

67. 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 government income or sovereign borrowing. They may be combined with private funds as initial investment or as long-term payments, or may take the form of governmental grants or guarantees. Infrastructure projects may be co-sponsored by the Government through equity participation in the concessionaire, thus reducing the amount of equity and debt capital needed from private sources (see chap. II, "Project risks and government support", paras. 40 and 41).

5. Main parties involved in implementing infrastructure projects

68. 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 main parties in the implementation of a typical privately financed infrastructure project involving the construction of a new infrastructure facility and carried out under the "project finance" modality.

(a) The contracting authority and other public authorities

69. The execution of a privately financed infrastructure project frequently involves a number of public authorities in the host country at the national, provincial or local level. The contracting authority is the main body responsible for the project within the Government. Furthermore, the execution of the project may necessitate the active participation (e.g. for the issuance of licences or permits) of other public authorities in addition to the contracting authority, at the same or at a different level of Government. Those authorities play a crucial role in the execution of privately financed infrastructure projects.

70. The contracting authority or another public authority 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 facility. Thereafter, the contracting authority conducts the process that leads to the selection of the concessionaire. Furthermore, throughout the life of the project, the Government may need to provide various forms of support—legislative, administrative, regulatory and sometimes financial—so as to ensure that the facility is successfully built and adequately operated. Finally, in some projects the Government may become the ultimate owner of the facility.

(b) The project company and the project promoters

71. Privately financed infrastructure projects are usually carried out by a joint venture of companies including construction and engineering companies and suppliers of heavy equipment interested in becoming the main contractors or suppliers of the project. The companies that participate in such a joint venture are referred to in the *Guide* as the "promoters" 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 timely and successful completion of the work. Furthermore, the participation of a company with experience in operating the type of facility being built is an important factor to ensure the long-term viability of the project. Where an independent legal entity is established by the project promoters, other equity investors not otherwise engaged in the project (usually institutional investors, investment banks, bilateral or multilateral lending institutions, sometimes also the Government or a government-owned corporation) may also participate. The participation of local investors, where the project company is required to be established under the laws of the host country (see chap. IV, "Construction and operation of infrastructure", paras. 12-18), is sometimes encouraged by the Government.

(c) Lenders

72. The risks to which the lenders are exposed in project finance, be it non-recourse or limited recourse, are considerably higher than in conventional transactions. This is even more the case where the security value of the physical assets involved (e.g. a road, bridge or tunnel) is difficult to realize, given the lack of a "market" where such assets could easily be sold, or act as obstacles to recovery or repossession. This circumstance affects not only the terms under which the loans are provided (e.g. the usually higher cost of project finance and extensive conditions to funding), but also, as a practical matter, the availability of funds.

73. Owing 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. Commercial banks that specialize in lending for certain industries are typically not ready to assume risks with which they are not familiar (for a discussion of project risks and risk allocation, see chap. II, "Project risks and government support", paras. 8-29). 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. 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 sometimes do so under a common loan agreement. Where various credit facilities are provided under separate loan agreements, the lenders will 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; and coordination of foreclosure on security provided by the project company.

(d) International financial institutions and export credit and investment promotion agencies

74. International financial institutions and export credit and investment promotion 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 are not 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. The methods and procedures applied to select the concessionaire will also be carefully considered by international financial institutions providing loans to the project. Many global and regional financial institutions and national development funding agencies have established guidelines or other requirements governing procurement with funds provided by them, which is typically reflected in their standard loan agreements (see also chap. III, "Selection of the concessionaire", para. 18).

(e) Insurers

75. 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 (see chap. IV, "Construction and operation of infrastructure", paras. 119 and 120). Those types of insurance are usually available on the commercial insurance markets, although the availability of commercial insurance may be limited for certain extraordinary events outside the control of the parties (e.g. war, riots, vandalism, earthquakes or hurricanes). The private insurance market is playing an increasing role in coverage against certain types of political risk, such as contract repudiation, failure by a public authority to perform its contractual obligations or unfair calls for independent guarantees. In some countries, insurance underwriters structure comprehensive insurance packages aimed at avoiding certain risks being left uncovered owing to gaps between individual insurance policies. 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 and the International Finance Corporation, by regional development banks or by export credit and investment promotion agencies (see chap. II, "Project risks and government support", paras. 61-74).

(f) Independent experts and advisers

76. Independent experts and advisers play an important role at various stages 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, international legal counsel or consulting engineers. Merchant and investment banks often act as advisers to project promoters in arranging the finance and in formulating the project to be implemented, an activity that, while essential to project finance, is quite distinct from the financing itself. Independent experts may advise the lenders to the project, for example, on the assessment of project risks in a specific host country. They may also assist public authorities 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 contracting authority 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.

77. In addition to private entities, a number of intergovernmental organizations (e.g. UNIDO and the regional commissions of the Economic and Social Council) and international financial institutions (e.g. the World Bank and the regional development banks) have special programmes whereby they may either provide this type of technical assistance directly to the Government or assist the latter in identifying qualified advisers.

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Chapter I. General legislative and institutional framework

CONTENTS

LEGISLATIVE RECOMMENDATIONS

For host countries wishing to promote privately financed infrastructure projects it is recommended that the following principles be implemented by the law:

Constitutional and legislative framework (see paras. 2-14)

Recommendation 1. The legislative and institutional framework for the implementation of privately financed infrastructure projects should ensure transparency, fairness and the long-term sustainability of projects. Undesirable restrictions on private sector participation in infrastructure development and operation should be eliminated.

Scope of authority to award concessions (see paras. 15-22)

Recommendation 2. The law should identify the public authorities of the host country (including, as appropriate, national, provincial and local authorities) that are empowered to enter into agreements for the implementation of privately financed infrastructure projects.

Recommendation 3. Privately financed infrastructure projects may include concessions for the construction and operation of new infrastructure facilities and systems or the maintenance, modernization, expansion and operation of existing infrastructure facilities and systems.

Recommendation 4. The law should identify the sectors or types of infrastructure in respect of which concessions may be granted.

Recommendation 5. The law should specify whether a concession might extend to the entire region under the jurisdiction of the respective contracting authority, to a geographical subdivision thereof or to a discrete project, and whether it might be awarded with or without exclusivity, as appropriate, in accordance with rules and principles of law, statutory provisions, regulations and policies applying to the sector concerned. Contracting authorities might be jointly empowered to award concessions beyond a single jurisdiction.

Administrative coordination (see paras. 23-29)

Recommendation 6. Institutional mechanisms should be established to coordinate the activities of the public authorities responsible for issuing approvals, licences, permits or authorizations required for the implementation of privately financed infrastructure projects in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned.

Authority to regulate infrastructure services (see paras. 30-53)

Recommendation 7. The authority to regulate infrastructure services should not be entrusted to entities that directly or indirectly provide infrastructure services.

Recommendation 8. Regulatory competence should be entrusted to functionally independent bodies with a level of autonomy sufficient to ensure that their decisions are taken without political interference or inappropriate pressures from infrastructure operators and public service providers.

Recommendation 9. The rules governing regulatory procedures should be made public. Regulatory decisions should state the reasons on which they are based and should be accessible to interested parties through publication or other means.

Recommendation 10. The law should establish transparent procedures whereby the concessionaire may request a review of regulatory decisions by an independent and impartial body and should set forth the grounds on which a request for review may be based and the availability of court review.

Recommendation 11. Where appropriate, special procedures should be established for handling disputes among public service providers concerning alleged violations of laws and regulations governing the relevant sector.

NOTES ON THE LEGISLATIVE RECOMMENDATIONS

A. GENERAL REMARKS

1. The establishment of an appropriate and effective legal framework is a prerequisite to creating an environment that fosters private investment in infrastructure. For countries where such a legal framework already exists, it is important to ensure that the law is sufficiently flexible and responsive to keep pace with the developments in various infrastructure sectors. This chapter deals with some general issues that domestic legislatures are advised to consider when setting up or reviewing the legal framework for privately financed infrastructure projects in order to achieve the above objectives. Section B (paras. 2-14) sets out general considerations on the constitutional and legislative framework; section C (paras. 15-22) deals with the scope of authority to award infrastructure and public services concessions; section D (paras. 23-29) discusses possible measures to enhance administrative coordination; and section E (paras. 30-53) deals with institutional and procedural arrangements for the regulation of infrastructure sectors.

B. CONSTITUTIONAL AND LEGISLATIVE FRAMEWORK

2. This section considers general guiding principles that may inspire the legal framework for privately financed infrastructure projects. It further points out the possible implications that the constitutional law of the host country may have for the implementation of these projects. Lastly, this section deals briefly with possible choices to be made regarding the level and type of instruments that might need to be enacted and their scope of application.

1. General guiding principles for a favourable constitutional and legislative framework

3. In considering the establishment of an enabling legal framework or in reviewing the adequacy of the existing framework, domestic legislators may wish to take into account some general principles that have inspired recent legislative actions in various countries, which are discussed briefly in the following paragraphs.

(a) Transparency

4. A transparent legal framework is characterized by clear and readily accessible rules and by efficient procedures for their application. Transparent laws and administrative procedures create predictability, enabling potential investors to estimate the costs and risks of their investment and thus to offer their most advantageous terms. Transparent laws and administrative procedures may also foster openness through provisions requiring the publication of administrative decisions and the disclosure of information of public relevance. They also help to guard against arbitrary or improper actions or decisions by the contracting authority or its officials and thus help to promote confidence in a country's infrastructure development programme. Transparency of laws and administrative procedures is of particular importance where foreign investment is sought, since foreign companies may be unfamiliar with the country's practices for the award of infrastructure projects.

(b) Fairness

5. The legal framework is both the means by which Governments regulate and ensure the provision of public services to their citizens and the means by which public service providers and their customers may protect their rights. A fair legal framework takes into account the various (and sometimes possibly conflicting) interests of the Government, the public service providers and their customers and seeks to achieve an equitable balance between them. The private sector's business considerations, the users' right to adequate services, both in terms of quality and price, the Government's responsibility for ensuring the continuous provision of essential services and its role in promoting national infrastructure development are but a few of the interests that deserve appropriate recognition in the law.

(c) Long-term sustainability

6. An important objective of domestic legislation on infrastructure development is to ensure the long-term provision of public services, with increasing attention being paid to environmental sustainability. Inadequate arrangements for the operation and maintenance of public infrastructure severely limit efficiency in all sectors of infrastructure and result directly in reduced service quality and increased costs for users. From a legislative perspective, it is important to ensure that the host country has the institutional capacity to undertake the various tasks entrusted to public authorities involved in infrastructure projects throughout their phases of implementation. Another measure to enhance the long-term sustainability of a national infrastructure policy is to achieve a correct balance between competitive and monopolistic provision of public services. Competition may reduce overall costs and provide more back-up facilities for essential services. In certain sectors, competition has also helped to increase the productivity of infrastructure investment, to enhance responsiveness to the needs of the customers and to obtain better quality for public services, thus improving the business environment in all sectors of the economy.

2. Constitutional law and privately financed infrastructure projects

7. 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 that 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 requirements that the State should participate in the capital of the companies providing public services.

8. For countries wishing to promote private investment in infrastructure it is important to review existing constitutional rules 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. Sometimes, concerns that those projects might contravene constitutional rules on State monopolies or on the provision of public services have led to judicial disputes, with a consequent negative impact on the implementation of the projects.

9. It is further important to take into account constitutional rules relating to the ownership of land or infrastructure facilities. The constitutional law of some countries contains limitations to private ownership of land and certain 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 can be an obstacle to the execution of projects that entail private operation, or private operation and ownership, of the relevant infrastructure (see further chap. IV, "Construction and operation of infrastructure", paras. 23-29).

3. General and sector-specific legislation

10. Legislation frequently plays a central role in promoting private investment in public infrastructure projects. The law typically embodies a political commitment, provides specific legal rights and may represent an important guarantee of stability of the legal and regulatory regime. In most countries, the implementation of privately financed infrastructure projects was in fact preceded by legislative measures setting forth the general rules under which those projects are awarded and executed.

11. In some countries, as a matter of constitutional law or legislative practice, specific legislation may need to be adopted in respect of individual projects. In other countries with a well-established tradition of awarding concessions to the private sector for the provision of public services, the Government is authorized by general legislation to award to the private sector any activity carried out by the public sector that has an economic value that makes such activity capable of being exploited by private entities. General 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.

12. However, by its very nature, general legislation is normally not suitable to address all the particular requirements of different sectors. Even in countries that have adopted general legislation addressing cross-sectoral issues, it has been found that supplementary sector-specific legislation allows the legislator to formulate rules that take into account the market structure in each sector (see above, "Introduction and background information on privately financed infrastructure projects", paras. 21-46). It should be noted that in many countries sector-specific legislation was adopted at a time when a significant portion, or even the entirety of the national infrastructure constituted State monopolies. For countries interested in promoting private sector investment in infrastructure it is advisable to review existing sector-specific legislation so as to ascertain its suitability for privately financed infrastructure projects.

13. Sector-specific legislation may further play an important role in establishing a framework for the regulation of individual infrastructure sectors (see below, paras. 30-53). Legislative guidance is particularly useful in countries at the initial stages of setting up or developing national regulatory capacities. Such legislation represents a useful assurance 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 legislative provisions dealing with contractual aspects of the implementation of privately financed infrastructure projects, which in most cases would not be adequate to their long-term nature (see further chap. IV, "Construction and operation of infrastructure", and chap. V, "Duration, extension and termination of the project agreement").

14. Many countries have used legislation to establish the general principles for the organization of infrastructure sectors and the basic policy, institutional and regulatory framework. However, the law may not be the best instrument to set detailed technical and financial requirements. Many countries have preferred to enact regulations setting forth more detailed rules to implement the general provisions of domestic laws on privately financed infrastructure projects. Regulations are found to be easier to adapt to a change in environment, whether the change results from the transition to market-based rules or from external developments, such as new technologies or changing economic or market conditions. Whatever the instrument used, clarity and predictability are of the essence.

C. SCOPE OF AUTHORITY TO AWARD CONCESSIONS

15. 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. The enactment

of express legislative authorization may be an important measure to foster the confidence of potential investors, national or foreign, in a national policy to promote private sector investment in infrastructure. Central elements to the authority to award concessions for infrastructure projects are discussed in the following paragraphs.

1. Authorized agencies and relevant fields of activity

16. In some legal systems the Government's responsibility for the provision of public services may not be delegated without prior legislative authorization. For those countries which wish to attract private investment in infrastructure, it is particularly important to state clearly in the law the authority to entrust entities other than public authorities of the host country with the right to provide certain public services. Such a general provision may be particularly important in those countries where public services are governmental 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 (see further chap. IV, "Construction and operation of infrastructure", paras. 37 and 38).

17. Where general legislation is adopted, it is also advisable to identify clearly the public authorities or levels of government competent to award infrastructure projects and to act as contracting authorities. In order to avoid unnecessary delay, it is particularly advisable to have rules in place that make it possible to ascertain the persons or offices that have the authority to enter into commitments on behalf of the contracting authority (and, as appropriate, of other public authorities) at different stages of negotiation and to sign the project agreement. It is 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. For projects involving offices or agencies at different levels of government (for example, national, provincial or local), where it is not possible to identify in advance all the relevant offices and agencies involved, other measures may be needed to ensure appropriate coordination among them (see below, paras. 23-29).

18. For purposes of clarity, it is advisable to identify in such general legislation those sectors in which concessions may be awarded. Alternatively, where this is not deemed feasible or desirable, the law might identify those activities which may not be the object of a concession (for example, activities related to national defence or security).

2. Purpose and scope of concessions

19. It may be useful for the law to define the nature and purpose of privately financed infrastructure projects for which concessions may be awarded in the host country. One possible approach may be to define the various categories of projects according to the extent of the rights and obligations assumed by the concessionaire (for example, "build-operate-transfer", "build-own-operate", "built-transfer-operate" and "build-transfer"). However, given the wide variety of schemes that may come into play in connection with private investment in infrastructure, it may be difficult to provide exhaustive definitions of all of them. As an alternative, the law could generally provide that concessions may be awarded for the purpose of entrusting an entity, private or public, with the obligation to carry out infrastructure works and deliver certain public services, in exchange for the right to charge a price for the use of the facility or premises or for the service or goods it generates, or for other payment or remuneration agreed to by the parties. The law could further clarify that concessions may be awarded for the construction and operation of a new infrastructure facility or system or for maintenance, repair, refurbishment, modernization, expansion and operation of existing infrastructure facilities and systems, or only for the management and delivery of a public service.

20. Another important issue concerns the nature of the rights vested in the concessionaire, in particular whether the right to provide the service is exclusive or whether the concessionaire will face the competition from other infrastructure facilities or service providers. Exclusivity may concern the right to provide a service in a particular geographical region (for example, a communal water distribution company) or embrace the whole territory of the country (for example, a national railway company); it may relate to the right to supply one particular type of goods or services to one particular customer (for example, a power generator being the exclusive regional supplier to a power transmitter and distributor) or to a limited group of customers (for example, a national long-distance telephone carrier providing connections to local telephone companies).

21. The decision whether or not to grant exclusivity rights to a certain project or category of projects should be taken in the light of the host country's policy for the sector concerned. As discussed earlier, the scope for competition varies considerably in different infrastructure sectors. While certain sectors, or segments thereof, have the characteristics of natural monopolies, in which case open competition is usually not an economically viable alternative, other infrastructure sectors have been successfully opened to free competition (see "Introduction and background information on privately financed infrastructure projects", paras. 28 and 29).

22. It is desirable therefore to deal with the issue of exclusivity in a flexible manner. Rather than excluding or prescribing exclusive concessions, it may be preferable for the law to authorize the grant of exclusive concessions when it is deemed to be in the public interest, such as in cases where the exclusivity is justified for the purpose of ensuring the technical or economical viability of the project. The contracting authority may be required to state the reasons for envisaging an exclusive concession prior to starting the procedure to select the concessionaire. Such general legislation may be supplemented by sector-specific laws regulating the issue of exclusivity in a manner suitable for each particular sector.

D. ADMINISTRATIVE COORDINATION

23. Depending on the administrative structure of the host country, privately financed infrastructure projects may require the involvement of several public authorities, at vari-

ous 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 public authority 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 public authority. For projects involving foreign investment, it may also happen that certain specific competences fall within the mandate of an agency responsible for approving foreign investment proposals.

24. Recent international experience has demonstrated the usefulness of entrusting a central unit within the host country's administration with the overall responsibility for formulating policy and providing practical guidance on privately financed infrastructure projects. Such a central unit may also be responsible for coordinating the input of the main public authorities that interface with the project company. It is recognized, however, that such an arrangement may not be possible in some countries, owing to their particular administrative organization. Where it is not feasible to establish such a central unit, other measures may be considered to ensure an adequate level of coordination among the various public authorities involved, as discussed in the following paragraphs.

1. Coordination of preparatory measures

25. One important measure to ensure the successful implementation of privately financed infrastructure projects is the requirement that the relevant public authority conduct a preliminary assessment of the project's 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 and the environmental impact of the project. The studies prepared by the contracting authority should, in particular, identify clearly the expected output of the project, provide sufficient justification for the investment, propose a modality for private sector participation and describe a particular solution to the output requirement.

26. Following the identification of the future project, it is for the Government to establish its relative priority and to assign human and other resources for its implementation. At that point, it is desirable that the contracting authority review existing statutory or regulatory requirements relating to the operation of infrastructure facilities of the type proposed with a view to identifying the main public authorities whose input will be required for the implementation of the project. It is also important at this stage to consider the measures that may be required in order for the contracting authority and the other public authorities involved to perform the obligations they may reasonably anticipate in connection with the project. For instance, the Government may need to make advance budgeting arrangements to enable the contracting authority or other public authorities to meet financial commitments that extend over several budgetary cycles, such as long-term commitments to purchase the project's output (see chap. IV, "Construction and operation of infrastructure", paras. 50 and 51). Furthermore, a series of administrative measures may be needed to implement certain forms of support provided to the project, such as tax exemptions and customs facilitation (see chap. II, "Project risks and government support", paras. 51-54), which may require considerable time.

2. Arrangements for facilitating the issuance of licences and permits

27. Legislation may play a useful role in facilitating the issuance of licences and permits that may be needed in the course of a project (such as licences under foreign exchange regulations; licences for the incorporation of the concessionaire; authorizations for the employment of foreigners; registration and stamp duties for the use or ownership of land; import licences for equipment and supplies; construction licences; licences for the installation of cables or pipelines; licences for bringing the facility into operation; and spectrum allocation for mobile communication). The required licences or permits may fall within the competence of various organs at different levels of the administration and the time required for their issuance may be significant, in particular when the approving organs or offices were not originally involved in conceiving the project or negotiating its terms. Delay in bringing an infrastructure project into operation as a result of missing licences or permits for reasons not attributable to the concessionaire is likely to result in an increase in the cost of the project and in the price paid by the users.

28. Thus, it is advisable to conduct an early assessment of licences and permits needed for a particular project in order to avoid delay in the implementation phase. A possible measure to enhance the coordination in the issuance of licences and permits might be to entrust one organ with the authority to receive the applications for licences and permits, to transmit them to the appropriate agencies and to monitor the issuance of all licences and permits 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 permits and provide a time period beyond which those licences and permits are deemed to be granted unless they are rejected in writing.

29. However, it should be noted that the distribution of administrative authority among various levels of government (for example, local, regional and central) often reflects fundamental principles of a country's political organization. Therefore, there are instances where the central Government would not be in a position to assume responsibility for the issuance of all licences and permits or to entrust one single body with such a coordinating function. In those cases, it is important to introduce measures to counter the possibility of delay that might result from such distribution of administrative authority, such as, for instance, agreements between the contracting authority and the other public authorities concerned to facilitate the procedures for a given project or other measures intended to ensure an adequate level of coordination among the various public authorities involved and to make the process of obtaining licences more transparent and efficient. Further-

more, the Government might consider providing some assurance that it will assist the concessionaire as much as possible in obtaining licences required by domestic law, for instance by providing information and assistance to bidders regarding the required licences, as well as the relevant procedures and conditions. From a practical point of view, in addition to coordination among various levels of government and various public authorities, there is a need to ensure consistency in the application of criteria for the issuance of licences and for the transparency of the administrative process.

E. AUTHORITY TO REGULATE INFRASTRUCTURE SERVICES

30. The provision of certain public services is generally subject to a special regulatory regime that may consist of substantive rules, procedures, instruments and institutions. That framework represents an important instrument to implement the governmental policy for the sector concerned (see "Introduction and background information on privately financed infrastructure projects", paras. 21-46). Depending on the institutional structure of the country concerned and on the allocation of powers between different levels of government, provincial or local legislation may govern some infrastructure sectors, in full or concurrently with national legislation.

31. Regulation of infrastructure services involves a wide range of general and sector-specific issues, which may vary considerably according to the social, political, legal and economic reality of each host country. While occasionally discussing some of the main regulatory issues that are encountered in a similar context in different sectors (see, for instance, chapter IV, "Construction and operation of infrastructure", paras. 39-46 and 82-95), the *Guide* is not intended to exhaust the legal or policy issues arising out of the regulation of various infrastructure sectors. The term "regulatory agencies" refers to the institutional mechanisms required to implement and monitor the rules governing the activities of infrastructure operators. Because the rules applicable to infrastructure operation often allow for a degree of discretion, a body is required to interpret and apply 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.

32. The *Guide* assumes that the host country has in place the proper institutional and bureaucratic structures and human resources necessary for the implementation of privately financed infrastructure projects. Nevertheless, as a contribution to domestic legislatures considering the need for, and desirability of, establishing regulatory agencies for monitoring the provision of public services, this section discusses some of the main institutional and procedural issues that may arise in that connection. The discussion contained in this section is illustrative of different options that have been used in domestic legislative measures to set up a regulatory framework for privately financed infrastructure projects, but the *Guide* does not thereby advocate the establishment of any particular model or administrative structure. Practical information and technical advice may be obtained from international financial institutions that carry out programmes to assist their member countries in setting up an adequate regulatory framework (such as the World Bank and the regional development banks).

1. Sectoral competence and mandate of regulatory agencies

33. 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 structure (for example, a common regulatory agency for power and gas or for airports and airlines). 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. In some countries the competence of regulatory agencies might also extend to several sectors within a given region.

34. Regulatory agencies whose competence is limited to a particular sector usually foster the development of technical, sector-specific expertise. Sector-specific regulation may facilitate the development of rules and practices that are tailored to the needs of the sector concerned. However, the decision between sector-specific and cross-sectoral regulation depends in part on the country's regulatory capacity. Countries with limited expertise and experience in infrastructure regulation may find it preferable to reduce the number of independent structures and try to achieve economies of scale.

35. The law setting up a regulatory mechanism often stipulates a number of general objectives that should guide the actions of regulatory agencies, 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 agencies and establish priorities among sometimes conflicting objectives. A clear mandate may also increase a regulatory agency's autonomy and credibility.

2. Institutional mechanisms

36. The range of institutional mechanisms for the regulation of infrastructure sectors varies greatly. While there are countries that entrust regulatory functions to organs of the Government (for example, the concerned ministries or departments), other countries have preferred to establish autonomous regulatory agencies, separate from the Government. Some countries have decided to subject certain infrastructure sectors to autonomous and independent regulation while leaving others under ministerial regulation. Sometimes, powers may also be shared between an autonomous regulatory agency and the Government, as is often

the case with respect to licensing. From a legislative perspective, it is important to devise institutional arrangements for the regulatory functions that ensure to the regulatory agency an adequate level of efficiency, taking into account the political, legal and administrative tradition of the country.

37. The efficiency of the regulatory regime is in most cases a function of the objectiveness with which regulatory decisions are taken. This, in turn, requires that regulatory agencies should be able to take decisions without interference or inappropriate pressures from infrastructure operators and public service providers. To that effect, legislative provisions in several countries require the independence of the regulatory decision-making process. In order to achieve the desired level of independence it is advisable to separate the 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. Regulatory independence is supplemented by provisions to prevent conflicts of interest, such as prohibitions for staff of the regulatory agency 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.

38. This leads to a related issue, namely the need 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. In some countries it was felt necessary to provide the regulatory agency with a certain degree of autonomy vis-à-vis the political organs of government. 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 (i.e. the availability of sufficient financial and human resources to discharge their responsibilities adequately).

3. Powers of regulatory agencies

39. Regulatory agencies 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, regulatory agencies were initially given limited powers, which were expanded later as the agencies established a track record of independence and professionalism. The legislation often specifies which powers are vested with the Government and which 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.

40. Selection of public service providers, for example, is in many countries a process involving the Government as well as the regulatory agency. 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 agency. In other cases, the Government may have to ask the regulatory agency's opinion prior to awarding a concession. On the other hand, some countries exclude direct involvement of regulatory agencies in the award process on the basis that it could affect the way they later regulate the provision of the service concerned.

41. The jurisdiction of regulatory agencies 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 agency 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.

42. The matters on which regulatory agencies have to pronounce themselves range from normative responsibilities (for example, rules on the award of concessions and conditions for certification of equipment) to the actual award of concessions; the modification of such instruments; the approval of contracts or decisions proposed by the regulated entities (for example, 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 and performance targets); price setting or adjustments; vetting of subsidies, exemptions or other advantages that could distort competition in the sector; sanctions; and dispute settlement.

4. Composition, staff and budget of regulatory agencies

43. When setting up a regulatory agency, a few countries have opted for an agency 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 agency, 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 have a casting vote.

44. To increase the regulatory agency's autonomy, different institutions may be involved in the nomination process. In some countries regulatory agencies 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 agency but subject to confirmation by parliament or upon nominations submitted by parliament, user associations or other bodies. Minimum professional qualifications are often required of the officials of the regulatory agencies, as well as the absence of conflicts of interest that might disqualify them from the function. Terms of office of mem-

bers of regulatory boards 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. Terms of office 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 criminal conviction, mental incapacitation, gross negligence or dereliction of duty). Regulatory agencies 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 advisers as needed.

45. Stable funding sources are critical in order for the regulatory agency to function adequately. In many countries, the budget of the regulatory agency is funded by fees and other levies on the regulated industry. Fees may be set as a percentage of the turnover of the public service providers or be levied for the award of licences, concessions or other authorizations. In some countries, the agency's budget is complemented as needed by budget transfers provided in the annual finance law. However, this may create an element of uncertainty that may reduce the agency's autonomy.

5. Regulatory process and procedures

46. The regulatory framework typically includes procedural rules governing the way the institutions in charge of the various regulatory functions have to exercise their powers. 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 agency. Rules and procedures should be objective and clear so as to ensure fairness, impartiality and timely action by the regulatory agency. For purposes of transparency, the law should require that they be made public. 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.

47. Transparency may be further enhanced, as required by some laws, by the publication by the regulatory agency of an annual report on the sector, including, for example, the decisions taken during the exercise, the disputes that have arisen and the way they were settled. Such an annual report may also include the accounts of the regulatory agency 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.

48. Regulatory decisions may have an 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 includes consultation procedures for major decisions or recommendations. In some countries, that 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 before major decisions and recommendations are made. To enhance transparency, comments, recommendations or opinions resulting from the consultation process may have to be published or made publicly available.

6. Recourse against decisions of the regulatory agency

49. Another important element of the host country's regulatory regime are the mechanisms whereby public service providers may request a review of regulatory decisions. As with the whole regulatory process, a high degree of transparency and credibility is essential. To be credible, the review should be entrusted to an entity that is independent from the regulatory agency taking the original decision, from the political authorities of the host country and from the public service providers.

50. Review of decisions of regulatory agencies is often in the jurisdiction of courts, but in some legal systems recourse against decisions by regulatory agencies is in the exclusive jurisdiction of special tribunals dealing solely with administrative matters, which in some countries are separate from the judicial system. If there are concerns over the review process (for example, as regards possible delays or the capacity of courts to make evaluations of the complex economic issues involved in regulatory decisions) review functions may be entrusted to another body, at least in the first instance, before a final recourse to courts or administrative tribunals. In some countries, requests for review are considered by a high-level cross-sectoral independent oversight body. There are also countries where requests for review are heard by a panel composed of persons holding specified judicial and academic functions. As to the grounds on which a request for review may be based, in many cases there are limits, in particular as to the right of the appellate body to substitute its own discretionary assessment of facts for the assessment of the body whose decision is being reviewed.

7. Settlement of disputes between public service providers

51. Disputes may arise between competing concessionaires (for example, two operators of cellular telephony systems) or between concessionaires providing services in different segments of the same infrastructure sector. Such disputes may involve allegations of unfair trade practices (for example, price dumping), uncompetitive practices inconsistent with the country's infrastructure policy (see "Introduction and background information on privately financed infrastructure projects", paras. 23-29) or violation of specific duties of public service providers (see chap. IV, "Construction and operation of infrastructure", paras. 82-93). In many countries, legislative provisions have been found necessary in order to establish an appropriate framework for the settlement of these disputes.

52. Firstly, the various parties may not have contractual arrangements with one another that could provide for an appropriate dispute settlement mechanism. Even where it would be possible to establish a contractual mechanism, the host country may have an interest that disputes involving

certain issues (for example, conditions of access to a given infrastructure network) be settled by a specific body in order to ensure consistency in the application of the relevant rules. Furthermore, certain disputes between public service providers may involve issues that, under the laws of the host country, are not considered to be capable of being settled through arbitration.

53. Domestic laws often establish administrative procedures for handling disputes between public service providers. Typically, public service providers may file complaints with the regulatory agency or with another governmental agency responsible for the application of the rules alleged to have been violated (for example, a governmental body in charge of enforcing competition laws and regulations), which in some countries has the authority to issue a binding decision on the matter. Such mechanisms, even where mandatory, do not necessarily preclude resort by the aggrieved persons to courts, although in some legal systems the courts may only have the power to control the legality of the decision (for example, observance of due process) but not its merits.

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Chapter II. Project risks and government support

CONTENTS

LEGISLATIVE RECOMMENDATIONS

For host countries wishing to promote privately financed infrastructure projects it is recommended that the following principles be implemented by the law:

Project risks and risk allocation (see paras. 8-29)

Recommendation 12. No unnecessary statutory or regulatory limitations should be placed upon the contracting authority's ability to agree on an allocation of risks that is suited to the needs of the project.

Government support (see paras. 30-60)

Recommendation 13. The law should clearly state which public authorities of the host country may provide financial or economic support to the implementation of privately financed infrastructure projects and which types of support they are authorized to provide.

NOTES ON THE LEGISLATIVE RECOMMENDATIONS

A. GENERAL REMARKS

1. Privately financed infrastructure projects create opportunities for reducing the commitment of public funds and other resources for infrastructure development and operation. They also make it possible to transfer to the private sector a number of risks that would otherwise be borne by the Government. The precise allocation of risks among the various parties involved is typically defined after consideration of a number of factors, including the public interest

in the development of the infrastructure in question and the level of risk faced by the project company, other investors and lenders (and the extent of their ability and readiness to absorb those risks at an acceptable cost). Adequate risk allocation is essential to reducing project costs and to ensuring the successful implementation of the project. Conversely, an inappropriate allocation of project risks may compromise the project's financial viability or hinder its efficient management, thus increasing the cost at which the service is provided.

2. In the past, debt financing for infrastructure projects was obtained on the basis of credit support from project sponsors, multilateral and national export credit agencies, Governments and other third parties. In recent years, these traditional sources have not been able to meet the growing needs for infrastructure capital and financing has been increasingly obtained on a project finance basis.

3. Project finance, as a method of financing, seeks to establish the creditworthiness of the project company on a "stand alone" basis, even before construction has begun or any revenues have been generated, and to borrow on the basis of that credit. Commentators have observed that project finance may hold the key to unlocking the vast pools of capital theoretically available in the capital markets for investment in infrastructure. However, project finance has distinctive and demanding characteristics from a financial point of view. Principal among these is that, in a project finance structure, financing parties must rely mainly upon the project company's assets and cash flows for repayment. If the project fails they will have no recourse, or only limited recourse, to the financial resources of a sponsor company or other third party for repayment (see also "Introduction and background information on privately financed infrastructure projects.", paras. 54 and 55).

4. The financial methodology of project financing requires a precise projection of the capital costs, revenues and projected costs, expenses, taxes and liabilities of the project. In order to predict these numbers precisely and with certainty and to create a financial model for the project, it is typically necessary to project the "base case" amounts of revenues, costs and expenses of the project company over a long period—often 20 years or more—in order to determine the amounts of debt and equity the project can support. Central to this analysis is the identification and quantification of risks. For this reason, the identification, assessment, allocation and mitigation of risks is at the heart of project financing from a financial point of view.

5. Among the most important, yet difficult, risks to assess and to mitigate are "political risks" (risks associated with adverse actions of the host Government, its agencies and its courts, in particular in granting licences and permits, adopting regulations applicable to the project company and its markets, taxation and the performance and enforcement of contractual obligations) and "currency risks" (risks related to the value, transferability and convertibility of the local currency). In order to guard against such risks, in particular, project finance structures have often incorporated insurance or guarantees of international financial institutions and export credit agencies as well as guarantees of the host Government.

6. Section B of the present chapter (paras. 8-29) gives an overview of the main risks encountered in privately financed infrastructure projects and contains a brief discussion of common contractual solutions for risk allocation, which emphasizes the need to provide the parties with the necessary flexibility for negotiating a balanced allocation of project risks. Section C (paras. 30-60) sets out policy considerations the Government may wish to take into account when designing the level of direct governmental support that may be provided to infrastructure projects, such as the degree of public interest in the execution of any given project and the need to avoid the assumption by the Government of open-ended or excessive contingent liabilities. Section C considers some additional support measures that have been used in governmental programmes to promote private investment in infrastructure development, without advocating the use of any of them in particular. Lastly, sections D (paras. 61-71) and E (paras. 72-74) outline guarantees and support measures that may be provided by export credit agencies and investment promotion agencies.

7. Other chapters of this *Guide* deal with related aspects of the host Government's legal regime that are of relevance to the credit and risk analysis of a project. Depending upon the sector and type of project the emphasis will, of course, vary. The reader is referred in particular to chapters IV, "Construction and operation of infrastructure"; V, "Duration, extension and termination of the project agreement"; VI, "Settlement of disputes"; and VII, "Other relevant areas of law".

B. PROJECT RISKS AND RISK ALLOCATION

8. As used in this chapter, the notion of "project risks" refers to those circumstances which, in the assessment of the parties, may have a negative effect on the benefit they expect to achieve with the project. While there may be events that would represent a serious risk for most parties (for example, the physical destruction of the facility by a natural disaster), each party's risk exposure will vary according to its role in the project.

9. The expression "risk allocation" refers to the determination of which party or parties should bear the consequences of the occurrence of events identified as project risks. For example, if the project company is obliged to deliver the infrastructure facility to the contracting authority with certain equipment in functioning condition, the project company is bearing the risk that the equipment may fail to function at the agreed performance levels. The occurrence of that project risk, in turn, may have a series of consequences for the project company, including its liability for failure to perform a contractual obligation under the project agreement or the applicable law (for example, payment of damages to the contracting authority for delay in bringing the facility into operation); certain losses (for example, loss of revenue as a result of delay in beginning operating the facility); or additional cost (for example, cost of repair of faulty equipment or of securing replacement equipment).

10. The party bearing a given risk may take preventive measures with a view to limiting the likelihood of the risk,

as well as specific measures to protect itself, in whole or in part, against the consequences of the risk. Such measures are often referred to as "risk mitigation". In the previous example, the project company will carefully review the reliability of the equipment suppliers and the technology proposed. The project company may require its equipment suppliers to provide independent guarantees concerning the performance of their equipment. The supplier may also be liable to pay penalties or liquidated damages to the project company for the consequences of failure of its equipment. In some cases, a more or less complex chain of contractual arrangements may be made to mitigate the consequences of a project risk. For instance, the project company may combine the guarantees provided by the equipment supplier with commercial insurance covering some consequences of the interruption of its business as a result of equipment failure.

1. Overview of main categories of project risk

11. For purposes of illustration, the following paragraphs provide an overview of the main categories of project risk and give examples of certain contractual arrangements used for risk allocation and mitigation. For further discussion on this subject, the reader is advised to consult other sources of information, such as the *UNIDO BOT Guidelines*.[2]

(a) Project disruption caused by events outside the control of the parties

12. The parties face the risk that the project may be disrupted by unforeseen or extraordinary events outside their control, which may be of a physical nature, such as natural disasters—floods, storms or earthquakes—or the result of human action, such as war, riots or terrorist attacks. Such unforeseen or extraordinary events may cause a temporary interruption of the project execution or the operation of the facility, resulting in construction delay, loss of revenue and other losses. Severe events may cause physical damage to the facility or even destruction beyond repair (for a discussion of the legal consequences of the occurrence of such events, see chap. IV, "Construction and operation of infrastructure", paras. 131-139).

(b) Project disruption caused by adverse acts of Government ("political risk")

13. The project company and the lenders face the risk that the project execution may be negatively affected by acts of the contracting authority, another agency of the Government or the host country's legislature. Such risks are often referred to as "political risks" and may be divided into three broad categories: "traditional" political risks (for example, nationalization of the project company's assets or imposition of new taxes that jeopardize the project company's prospects of debt repayment and investment recovery); regulatory risks (for example, introduction of more stringent standards for service delivery or opening of a sector to competition) and "quasi-commercial" risks (for example, breaches by the contracting authority or project interruptions due to changes in the contracting authority's priorities and plans) (for a discussion of the legal consequences of the occurrence of such events, see chap. IV, "Construction and operation of infrastructure", paras. 122-125). In addition to political risks originating from the host country, some political risks may result from acts of a foreign Government, such as blockades, embargoes or boycotts imposed by the Governments of the investors' home countries.

(c) Construction and operation risks

14. The main risks that the parties may face during the construction phase are the risks that the facility cannot be completed at all or cannot be delivered according to the agreed schedule (completion risk); that the construction cost exceeds the original estimates (construction cost overrun risk); or that the facility fails to meet performance criteria at completion (performance risk). Similarly, during the operational phase the parties may face the risk that the completed facility cannot be effectively operated or maintained to produce the expected capacity, output or efficiency (performance risk); or that the operating costs exceed the original estimates (operation cost overrun). It should be noted that construction and operation risks do not affect only the private sector. The contracting authority and the users in the host country may be severely affected by an interruption in the provision of needed services. The Government, as representative of the public interest, will be generally concerned about safety risks or environmental damage caused by improper operation of the facility.

15. Some of these risks may be brought about by the project company or its contractors or suppliers. For instance, construction cost overrun and delay in completion may be the result of inefficient construction practices, waste, insufficient budgeting or lack of coordination among contractors. Failure of the facility to meet performance criteria may also be the result of defective design, inadequacy of the technology used or faulty equipment delivered by the project company's suppliers. During the operational phase, performance failures may be the consequence, for example, of faulty maintenance of the facility or negligent operation of mechanical equipment. Operation cost overruns may also derive from inadequate management.

16. However, some of these risks may also result from specific actions taken by the contracting authority, by other public authorities or even the host country's legislature. Performance failures or cost overruns may be the consequence of the inadequacy of the technical specifications provided by the contracting authority during the selection of the concessionaire. Delays and cost overruns may also be brought about by actions of the contracting authority subsequent to the award of the project (delays in obtaining approvals and permits, additional costs caused by changes in requirements due to inadequate planning, interruptions caused by inspecting agencies or delays in delivering the land on which the facility is to be built). General legislative or regulatory measures, such as more stringent safety or

[2]See "Introduction and background information on privately financed infrastructure projects", footnote 1 on page 74.

labour standards, may also result in higher construction or operating costs. Shortfalls in production may be caused by the non-delivery of the necessary supplies (for example, power or gas) on the part of public authorities.

(d) Commercial risks

17. "Commercial risks" relate to the possibility that the project cannot generate the expected revenue because of changes in market prices or demand for the goods or services it generates. Both of these forms of commercial risk may seriously impair the project company's capacity to service its debt and may compromise the financial viability of the project.

18. Commercial risks vary greatly according to the sector and type of project. The risk may be regarded as minimal or moderate where the project company has a monopoly over the service concerned or when it supplies a single client through a standing off-take agreement. However, commercial risks may be considerable in projects that depend on market-based revenues, in particular where the existence of alternative facilities or supply sources makes it difficult to establish a reliable forecast of usage or demand. This may be a serious concern, for instance, in tollroad projects, since tollroads face competition from toll-free roads. Depending on the ease with which drivers may have access to toll-free roads, the toll revenues may be difficult to forecast, especially in urban areas where there may be many alternative routes and roads may be built or improved continuously. Furthermore, traffic usage has been found to be even more difficult to forecast in the case of new tollroads, especially those which are not an addition to an existing toll facility system, because there is no existing traffic to use as an actuarial basis.

(e) Exchange rate and other financial risks

19. Exchange rate risk relates to the possibility that changes in foreign exchange rates alter the exchange value of cash flows from the project. Prices and user fees charged to local users or customers will most likely be paid for in local currency, while the loan facilities and sometimes also equipment or fuel costs may be denominated in foreign currency. This risk may be considerable, since exchange rates are particularly unstable in many developing countries or countries whose economies are in transition. In addition to exchange rate fluctuations, the project company may face the risk that foreign exchange control or lowering reserves of foreign exchange may limit the availability in the local market of foreign currency needed by the project company to service its debt or repay the original investment.

20. Another risk faced by the project company concerns the possibility that interest rates may rise, forcing the project to bear additional financing costs. This risk may be significant in infrastructure projects given the usually large sums borrowed and the long duration of the project, with some loans extending over a period of several years. Loans are often given at a fixed rate of interest (for example, fixed-rate bonds) to reduce the interest rate risk. In addition, the finance package may include hedging facilities against interest rate risks, for example, by way of interest rate swaps or interest rate caps.

2. Contractual arrangements for risk allocation and mitigation

21. It follows from the above that the parties need to take into account a wide range of factors to allocate project risks effectively. For this reason, it is generally not advisable to have in place statutory provisions that limit unnecessarily the negotiators' ability to achieve a balanced allocation of project risks, as appropriate to the needs of individual projects. Nevertheless, it may be useful for the Government to provide some general guidance to officials acting on behalf of domestic contracting authorities, for instance, by formulating advisory principles on risk allocation.

22. Practical guidance provided to contracting authorities in a number of countries often refers to general principles for the allocation of project risks. One such principle is that specific risks should normally be allocated to the party best able to assess, control and manage the risk. Additional guiding principles envisage the allocation of project risks to the party with the best access to hedging instruments (that is, investment schemes to offset losses in one transaction by realizing a simultaneous gain on another) or the greatest ability to diversify the risks or to mitigate them at the lowest cost. In practice, however, risk allocation is often a factor of both policy considerations (for example, the public interest in the project or the overall exposure of the contracting authority under various projects) and the negotiating strength of the parties. Furthermore, in allocating project risks it is important to consider the financial strength of the parties to which a specific risk is allocated and their ability to bear the consequences of the risk, should it occur.

23. It is usually for the project company and its contractors to assume ordinary risks related to the development and operation of the infrastructure. For instance, completion, cost overrun and other risks typical of the construction phase are usually allocated to the construction contractor or contractors through a turnkey construction contract, whereby the contractor assumes full responsibility for the design and construction of the facility at a fixed price, within a specified completion date and according to particular performance specifications (see chap. IV, "Construction and operation of infrastructure", para. 70). The construction contractor is typically liable to pay liquidated damages or penalties for any late completion. In addition, the contractor is also usually required to provide a guarantee of performance, such as a bank guarantee or a surety bond. Separate equipment suppliers are also usually required to provide guarantees in respect of the performance of their equipment. Guarantees of performance provided by contractors and equipment suppliers are often complemented by similar guarantees provided by the concessionaire to the benefit of the contracting authority. Similarly, the project company typically mitigates its exposure to operation risks by entering into an operation and maintenance contract in which the operating company undertakes to achieve the required output and assumes the liability for the consequences of operational failures. In most cases,

arrangements of this type will be an essential requirement for a successful project. The lenders, for their part, will seek protection against the consequences of those risks, by requiring the assignment of the proceeds of any bonds issued to guarantee the contractor's performance, for instance. Loan agreements typically require that the proceeds from contract bonds be deposited in an account pledged to the lenders (that is, an "escrow account"), as a safeguard against misappropriation by the project company or against seizure by third parties (for example, other creditors). Nevertheless, the funds paid under the bonds are regularly released to the project company as needed to cover repair costs or operating and other expenses.

24. The contracting authority, on the other hand, will be expected to assume those risks which relate to events attributable to its own actions, such as inadequacy of technical specifications provided during the selection process or delay caused by failure to provide agreed supplies on time. The contracting authority may also be expected to bear the consequences of disruptions caused by acts of Government, for instance by agreeing to compensate the project company for loss of revenue due to price control measures (see chap. IV, "Construction and operation of infrastructure", para. 124). While some political risks may be mitigated by procuring insurance, such insurance, if at all available for projects in the country concerned, may not be obtainable at an acceptable cost. Thus, prospective investors and lenders may turn to the Government, for instance, to obtain assurances against expropriation or nationalization and guarantees that proper compensation will be payable in the event of such action (see para. 50). Depending on their assessment of the level of risk faced in the host country, prospective investors and lenders may not be ready to pursue a project in the absence of those assurances or guarantees.

25. Most of the project risks referred to in the preceding paragraphs can, to a greater or lesser extent, be regarded as falling within the control of one party or the other. However, a wide variety of project risks result from events outside the control of the parties or are attributable to the acts of third parties and other principles of risk allocation may thus need to be considered.

26. For example, the project company could expect that the interest rate risk, together with the inflation risk, would be passed on to the end-users or customers of the facility through price increases, although this may not always be possible because of market-related circumstances or price control measures. The price structure negotiated between the project company and the contracting authority will determine the extent to which the project company will avoid those risks or whether it will be expected to absorb some of them (see chap. IV, "Construction and operation of infrastructure", paras. 36-46).

27. Another category of risk that may be allocated under varying schemes concerns extraneous events such as war, civil disturbance, natural disasters or other events wholly outside the control of the parties. In traditional infrastructure projects carried out by the public sector, the public entity concerned usually bears the risk, for example, of destruction of the facility by natural disasters or similar events, to the extent that those risks may not be insurable. In privately financed infrastructure projects the Government may prefer this type of risk to be borne by the project company. However, depending on their assessment of the particular risks faced in the host country, the private sector may not be ready to bear those risks. Therefore, in practice there is not a single solution to cover this entire category of risk and special arrangements are often made to deal with each of them. For example, the parties may agree that the occurrence of some of those events may exempt the affected party from the consequences of failure to perform under the project agreement and there will be contractual arrangements providing solutions for some of their adverse consequences, such as contract extensions to compensate for delay resulting from events or even some form of direct payment under special circumstances (see chap. IV, "Construction and operation of infrastructure", paras. 131-139). Those arrangements will be supplemented by commercial insurance purchased by the project company, where available at an acceptable cost (see chap. IV, "Construction and operation of infrastructure", paras. 119 and 120).

28. Special arrangements may also need to be negotiated for the allocation of commercial risks. Projects such as mobile telecommunication projects usually have a relatively high direct cost recovery potential and in most cases the project company is expected to carry out the project without sharing those risks with the contracting authority and without recourse to support from the Government. In other infrastructure projects, such as power-generation projects, the project company may revert to contractual arrangements with the contracting authority or other public authority in order to reduce its exposure to commercial risks, for example, by negotiating long-term off-take agreements that guarantee a market for the product at an agreed price. Payments may take the form of actual consumption or availability charges or combine elements of both; the applicable rates are usually subject to escalation or indexation clauses in order to protect the real value of revenues from the increased costs of operating an ageing facility (see also chap. IV, "Construction and operation of infrastructure", paras. 50 and 51). Lastly, there are relatively capital-intensive projects with more slowly developing cost recovery potential, such as water supply and some tollroad projects, which the private sector may be reluctant to carry out without some form of risk-sharing with the contracting authority, for example, through fixed revenue assurances or agreed capacity payments regardless of actual usage (see also chap. IV, "Construction and operation of infrastructure", paras. 48 and 49).

29. The risk allocation eventually agreed to by the contracting authority and the project company will be reflected in their mutual rights and obligations, as set forth in the project agreement. The possible legislative implications of certain provisions commonly found in project agreements are discussed in other chapters of the *Guide* (see chaps. IV, "Construction and operation of infrastructure", and V, "Duration, extension and termination of the project agreement"). Various other agreements will also be negotiated by the parties to mitigate or reallocate the risks they assume (for example, loan agreements; construction, equipment supply, operation and maintenance contracts; direct agreement between the contracting authority and the lenders; and off-take and long-term supply agreements, where applicable).

C. GOVERNMENT SUPPORT

30. The discussion in the preceding section shows that the parties may use various contractual arrangements to allocate and mitigate project risks. Nevertheless, those arrangements may not always be sufficient to ensure the level of comfort required by private investors to participate in privately financed infrastructure projects. It may also be found that certain additional government support is needed to enhance the attractiveness of private investment in infrastructure projects in the host country.

31. Government support may take various forms. Generally, any measure taken by the Government to enhance the investment climate for infrastructure projects may be regarded as governmental support. From that perspective, the existence of legislation enabling the Government to award privately financed infrastructure projects or the establishment of clear lines of authority for the negotiation and follow-up of infrastructure projects (see chap. I, "General legislative and institutional framework", paras. 23-29) may represent important measures to support the execution of infrastructure projects. As used in the *Guide*, however, the expression "government support" has a narrower connotation and refers in particular to special measures, in most cases of a financial or economic nature, that may be taken by the Government to enhance the conditions for the execution of a given project or to assist the project company in meeting some of the project risks, above and beyond the ordinary scope of the contractual arrangements agreed to between the contracting authority and the project company to allocate project risks. Government support measures, where available, are typically an integral part of governmental programmes to attract private investment for infrastructure projects.

1. Policy considerations relating to government support

32. In practice, a decision to support the implementation of a project is based on an assessment by the Government of the economic or social value of the project and whether that justifies additional governmental support. The Government may estimate that the private sector alone may not be able to finance certain projects at an acceptable cost. The Government may also consider that particular projects may not materialize without certain support measures that mitigate some of the project risks. Indeed, the readiness of private investors and lenders to carry out large projects in a given country is not only based on their assessment of specific project risks, but is also influenced by their comfort with the investment climate in the host country, in particular in the infrastructure sector. Factors to which private investors may attach special importance include the host country's economic system and the degree of development of market structures and the degree to which the country has already succeeded with privately financed infrastructure projects over a period of years.

33. For the above reasons, a number of countries have adopted a flexible approach for dealing with the issue of governmental support. In some countries, this has been done by legislative provisions that tailor the level and type of support to the specific needs of individual infrastructure sectors. In other countries, this has been achieved by providing the host Government with sufficient legislative authority to extend certain types of assurance or guarantee while preserving its discretion not to make them available in all cases. However, the host Government will be interested in ensuring that the level and type of support provided to the project does not result in the assumption of open-ended liabilities. Indeed, over-commitment of public authorities through guarantees given to a specific project may prevent them from extending guarantees in other projects of perhaps even greater public interest.

34. The efficiency of governmental support programmes for private investment in infrastructure may be enhanced by the introduction of appropriate techniques for budgeting for governmental support measures or for assessing the total cost of other forms of governmental support. For example, loan guarantees provided by public authorities usually have a cost lower than the cost of loan guarantees provided by commercial lenders. The difference (less the value of fees and interests payable by the project company) represents a cost for the Government and a subsidy for the project company. However, loan guarantees are often not recorded as expenses until such time as a claim is made. Thus, the actual amount of the subsidy granted by the Government is not recorded, which may create the incorrect impression that loan guarantees entail a lesser liability than direct subsidy payments. Similarly, the financial and economic cost of tax exemptions granted by the Government may not be apparent, which makes them less transparent than other forms of direct governmental support. For these reasons, countries that are contemplating establishing support programmes for privately financed infrastructure projects may need to devise special methods for estimating the budgetary cost of support measures such as tax exemptions, loans and loan guarantees provided by public authorities that take into account the expected present value of future costs or loss of revenue.

2. Forms of government support

35. The availability of direct governmental support, be it in the form of financial guarantees, public loans or revenue assurances, may be an important element in the financial structuring of the project. The following paragraphs briefly describe forms of governmental support that are sometimes authorized under domestic laws and discuss possible legislative implications they may have for the host country, without advocating the use of any of them in particular.

36. Generally, besides the administrative and budgetary measures that may be needed to ensure the fulfilment of governmental commitments throughout the duration of the project, it is advisable for the legislature to consider the possible need for an explicit legislative authorization to provide certain forms of support. Where government support is found advisable, it is important for the legislature to bear in mind the host country's obligations under international agreements on regional economic integration or trade liberalization, which may limit the ability of public authorities of the contracting States to provide support, financial or otherwise, to companies operating in their territories.

Furthermore, where a Government is contemplating support for the execution of an infrastructure project, that circumstance should be made clear to all prospective bidders at an appropriate time during the selection proceedings (see chap. III, "Selection of the concessionaire", para. 67).

(a) Public loans and loan guarantees

37. In some cases, the law authorizes the Government to extend interest-free or low-interest loans to the project company to lower the project's financing cost. Depending on the accounting rules to be followed, some interest-free loans provided by public agencies can be recorded as revenue in the project company's accounts, with loan payments being treated as deductible costs for tax and accounting purposes. Moreover, subordinate loans provided by the Government may enhance the financial terms of the project by supplementing senior loans provided by commercial banks without competing with senior loans for repayment. Governmental loans may be generally available to all project companies in a given sector or they may be limited to providing temporary assistance to the project company in the event that certain project risks materialize. The total amount of any such loan may be further limited to a fixed sum or to a percentage of the total project cost.

38. In addition to public loans, some national laws authorize the contracting authority or other agency of the host Government to provide loan guarantees for the repayment of loans taken by the project company. Loan guarantees are intended to protect the lenders (and, in some cases, investors providing funds to the project as well) against default by the project company. Loan guarantees do not entail an immediate disbursement of public funds and they may appear more attractive to the Government than direct loans. However, loan guarantees may represent a substantial contingent liability and the Government's exposure may be significant, especially in the event of total failure by the project company. Indeed, the Government would in most cases find little comfort in a possible subrogation in the rights of the lenders against an insolvent project company.

39. Thus, in addition to introducing general measures to enhance the efficiency of governmental support programmes (see para. 34), it may be advisable to consider concrete provisions to limit the Government's exposure under loan guarantees. Rules governing the provision of loan guarantees may provide a maximum ceiling, which could be expressed as a fixed sum or, if more flexibility is needed, a certain percentage of the total investment in any given project. Another measure to circumscribe the contingent liabilities of the guaranteeing agency may be to define the circumstances under which such guarantees may be extended, taking into account the types of project risk the Government may be ready to share. For instance, if the Government considers sharing only the risks of temporary disruption caused by events outside the control of the parties, the guarantees could be limited to the event that the project company is rendered temporarily unable to service its loans owing to the occurrence of specially designated unforeseeable events outside the project company's control. If the Government wishes to extend a greater degree of protection to the lenders, the guarantees may cover the project company's permanent failure to repay its loans for the same reasons. In such a case, however, it is advisable not to remove the incentives for the lenders to arrange for the continuation of the project, for instance by identifying another suitable concessionaire or by stepping in through an agent appointed to remedy the project company's default (see chap. IV, "Construction and operation of infrastructure", paras. 147-150). The call on the governmental guarantees could thus be conditional upon the prior exhaustion of other remedies available to the lenders under the project agreement, the loan agreements or their direct agreements with the contracting authority, if any. In any event, full loan guarantees by the Government amounting to a total protection of the lenders against the risk of default by the project company are not a common feature of infrastructure projects carried out under the project finance modality.

(b) Equity participation

40. Another form of additional support by the Government may consist of direct or indirect equity participation in the project company. Equity participation by the Government may help achieve a more favourable ratio between equity and debt by supplementing the equity provided by the project sponsors, in particular where other sources of equity capital, such as investment funds, cannot be tapped by the project company. Equity investment by the Government may also be useful to satisfy legal requirements of the host country concerning the composition of locally established companies. The company laws of some jurisdictions, or special legislation on infrastructure projects, require a certain amount of participation of local investors in locally established companies. However, it may not always be possible to secure the required level of local participation on acceptable terms. Local investors may lack the interest or financial resources to invest in large infrastructure projects; they may also be averse to or lack experience in dealing with specific project risks.

41. Governmental participation may involve certain risks that the Government may wish to consider. In particular, there is a risk that such participation may be understood as an implied guarantee by the Government, so that the parties, or even third parties, may expect the Government to back the project fully or eventually even take it over at its own cost if the project company fails. Where such an implied guarantee is not intended, appropriate provisions should be made to clarify the limits of governmental involvement in the project.

(c) Subsidies

42. Tariff subsidies are used in some countries to supplement the project company's revenue when the actual income of the project falls below a certain minimum level. The provision of the services in some areas where the project company is required to operate may not be a profitable undertaking, because of low demand or high operational costs or because the project company is required to provide the service to a certain segment of the population at low cost. Thus, the law in some countries authorizes the

Government to undertake to extend subsidies to the project company in order to make it possible to provide the services at a lower price.

43. Subsidies usually take the form of direct payments to the project company, either lump-sum payments or payments calculated specifically to supplement the project company's revenue. In the latter case, the Government should ensure that it has in place adequate mechanisms for verifying the accuracy of subsidy payments made to the project company, by means, for example, of audit and financial disclosure provisions in the project agreement. An alternative to direct subsidies may be to allow the project company to cross-subsidize less profitable activities with revenue earned in more profitable ones. This may be done by combining in the same concession both profitable and less profitable activities or areas of operation, or by granting to the project company the commercial exploitation of a separate and more profitable ancillary activity (see paras. 48-60).

44. However, it is important for the legislature to consider practical implications and possible legal obstacles to the provision of subsidies to the project company. For example, subsidies are found to distort free competition and the competition laws of many countries prohibit the provision of subsidies or other forms of direct financial aid that are not expressly authorized by legislation. Subsidies may also be inconsistent with the host country's international obligations under international agreements on regional economic integration or trade liberalization.

(d) Sovereign guarantees

45. In connection with privately financed infrastructure projects, the term "sovereign guarantees" is sometimes used to refer to any of two types of guarantee provided by the host Government. The first type includes guarantees issued by the host Government to cover the breach of obligations assumed by the contracting authority under the project agreement. A second category includes guarantees that the project company will not be prevented by the Government from exercising certain rights that are granted to it under the project agreement or that derive from the laws of the country, for example, the right to repatriate profits at the end of the project. Whatever form such guarantees may take, it is important for the Government and the legislature to consider the Government's ability to assess and manage efficiently its own exposure to project risks and to determine the acceptable level of direct or contingent liabilities it can assume.

(i) Guarantees of performance by the contracting authority

46. Performance guarantees may be used where the contracting authority is a separate or autonomous legal entity that does not engage the responsibility of the Government itself. Such guarantees may be issued in the name of the Government or of a public financial institution of the host country. They may also take the form of a guarantee issued by international financial institutions that are backed by a counter-guarantee by the Government (see paras. 61-71). Guarantees given by the Government may be useful instruments to protect the project company from the consequences of default by the contracting authority or other public authority assuming specific obligations under the project agreement. The most common situations in which such guarantees are used include the following:

(a) Off-take guarantees. Under these arrangements, the Government guarantees payment of goods and services supplied by the project company to public entities. Payment guarantees are often used in connection with payment obligations under off-take agreements in the power-generation sector (see chap. IV, "Construction and operation of infrastructure", para. 50). Such guarantees may be of particular importance where the main or sole customer of the project company is a government monopoly. Additional comfort is provided to the project company and lenders when the guarantee is subscribed by an international financial institution;

(b) Supply guarantees. Supply guarantees may also be provided to protect the project company from the consequences of default by public sector entities providing goods and supplies required for the operation of the facility—fuel, electricity or water, for example—or to secure payment of indemnities for which the contracting entity may become liable under the supply agreement;

(c) General guarantees. These are guarantees intended to protect the project company against any form of default by the contracting authority, rather than default on specifically designated obligations. Although general performance guarantees may not be very frequent, there are cases in which the project company and the lenders may regard them as a condition necessary for executing the project. This may be the case, for example, where the obligations undertaken by the contracting authority are not commensurate with its creditworthiness, as may happen in connection with large concessions granted by municipalities or other autonomous entities. Guarantees by the Government may be useful to ensure specific performance, for example, when the host Government undertakes to substitute for the contracting entity in the performance of certain acts (for example, delivery of an appropriate site for disposal of by-products).

47. Generally, it is important not to overestimate the adequacy of sovereign guarantees alone to protect the project company against the consequences of default by the contracting authority. Except when their purpose is to ensure specific performance, sovereign guarantees usually have a compensatory function. Thus, they may not substitute for appropriate contractual remedies in the event of default by the contracting authority (see chap. IV, "Construction and operation of infrastructure", paras. 140-150). Different types of contractual remedies, or combinations thereof, may be used to deal with various events of default, for example, liquidated damages in the event of default and price increases or contract extensions in the event of additional delay in project execution caused by acts of the contracting authority. Furthermore, in order to limit the Government's exposure and to reduce the risk of calls on the guarantee, it is advisable to consider measures to encourage the contracting authority to live up to its obligations under

the project agreement or to make efforts to control the causes of default. Such measures may include express subrogation rights of the guarantor against the contracting authority or internal control mechanisms to ensure the accountability of the contracting authority or its agents in the event, for instance, of wanton or reckless breach of its obligations under the project agreement resulting in a call on the sovereign guarantee.

(ii) Guarantees against adverse acts of Government

48. Unlike performance guarantees, which protect the project company against the consequences of default by the contracting authority, the guarantees considered here relate to acts of other authorities of the host country that are detrimental to the rights of the project company or otherwise substantially affect the implementation of the project agreement. Such guarantees are often referred to as "political risk guarantees".

49. One type of guarantee contemplated in national laws consists of foreign exchange guarantees, which usually fulfil three functions: to guarantee the convertibility of the local earnings into foreign currency, to guarantee the availability of the required foreign currency and to guarantee the transferability abroad of the converted sums. Foreign exchange guarantees are common in privately financed infrastructure projects involving a substantial amount of debt denominated in currencies other than the local currency, in particular in those countries which do not have freely convertible currencies. Some laws also provide that such a guarantee may be backed by a bank guarantee issued in favour of the project company. A foreign exchange guarantee is not normally intended to protect the project company and the lenders against the risks of exchange rate fluctuation or market-induced devaluation, which are considered to be ordinary commercial risks. However, in practice, Governments have sometimes agreed to assist the project company in cases where the project company is unable to repay its debts in foreign currency owing to extreme devaluation of the local currency.

50. Another important type of guarantee may be to assure the company and its shareholders that they will not be expropriated without adequate compensation. Such a guarantee would typically extend both to confiscation of property owned by the project company in the host country and to the nationalization of the project company itself, that is, confiscation of shares of the project company's capital. This type of guarantee is usually provided for in laws dealing with direct foreign investment and in bilateral investment protection treaties (see chap. VII, "Other relevant areas of law", ___).

(e) Tax and customs benefits

51. Another method for the host Government to support the execution of privately financed projects could be to grant some form of tax and customs exemption, reduction or benefit. Domestic legislation on foreign direct investment often provides special tax regimes to encourage foreign investment and in some countries it has been found useful expressly to extend such a taxation regime to foreign companies participating in privately financed infrastructure projects (see also chap. VII, "Other relevant areas of law", __).

52. Typical tax exemptions or benefits include exemption from income or profit tax or from property tax on the facility, or exemptions from income tax on interest due on loans and other financial obligations assumed by the project company. Some laws provide that all transactions related to a privately financed infrastructure project will be exempted from stamp duties or similar charges. In some cases, the law establishes some preferential tax treatment or provides that the project company will benefit from the same favourable tax treatment generally given to foreign investments. Sometimes the tax benefit takes the form of a more favourable income tax rate, combined with a decreasing level of exemption during the initial years of the project. Such exemptions and benefits are sometimes extended to the contractors engaged by the project company, in particular foreign contractors.

53. Further taxation measures sometimes used to promote privately financed infrastructure projects are exemptions from withholding tax to foreign lenders providing loans to the project. Under many legal systems, any interest, commission or fee in connection with a loan or indebtedness that is borne directly or indirectly by locally established companies or is deductible against income earned locally is deemed to be local income for taxation purposes. Therefore, both local and foreign lenders to infrastructure projects may be liable to the payment of income tax in the host country, which the project company may be required to withhold from payments to foreign lenders, as non-residents of the host country. Income tax due by the lenders in the host country is typically taken into account in the negotiations between the project company and the lenders and may result in a higher financial cost for the project. In some countries, the competent organs are authorized to grant exemptions from withholding tax in connection with payments to non-residents that are found to be made for a purpose that promotes or enhances the economic or technological development of the host country or are otherwise deemed to be related to a purpose of public relevance

54. Besides tax benefits or exemptions, national laws sometimes facilitate the import of equipment for the use of the project company by means of exemption from customs duties. Such exemption typically applies to the payment of import duties on equipment, machinery, accessories, raw materials and materials imported into the country for purposes of conducting preliminary studies, designing, constructing and operating infrastructure projects. In the event that the project company wishes to transfer or sell the imported equipment on the domestic market, the approval of the contracting authority usually needs to be obtained and the relevant import duties, turnover tax or other taxes need to be paid in accordance with the laws of the country. Sometimes the law authorizes the Government either to grant an exemption from customs duty or to guarantee that the level of duty will not be raised to the detriment of the project.

(f) Protection from competition

55. An additional form of governmental support may consist of assurances that no competing infrastructure project will be developed for a certain period or that no agency of the Government will compete with the project company, directly or through another concessionaire. Assurances of this sort serve as a guarantee that the exclusivity rights that may be granted to the concessionaire (see chap. I, "General legislative and institutional framework", paras. 20-22) will not be nullified during the life of the project. Protection from competition may be regarded by the project company and the lenders as an essential condition for participating in the development of infrastructure in the host country. 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.

56. Provisions of this type may be intended to foster the confidence of the project sponsors and the lenders that the basic assumptions under which the project was awarded will be respected. However, they may be inconsistent with the host country's international obligations under agreements on regional economic integration and trade liberalization. Furthermore, they may limit the ability of the Government to deal with an increase in the demand for the service concerned as the public interest may require or to ensure the availability of the services to various categories of user. It is therefore important to consider carefully the interests of the various parties involved. For instance, the required price level to allow profitable exploitation of a tollroad may exceed the paying capacity of low-income segments of the public. Thus, the contracting authority may have an interest in maintaining open to the public a toll-free road as an alternative to a new tollroad. At the same time, however, if the contracting authority decides to improve or upgrade the alternative road, the traffic flow may be diverted from the tollroad built by the project company, thus affecting its flow of income. Similarly, the Government may wish to introduce free competition for the provision of long-distance telephone services in order to expand the availability and reduce the cost of telecommunication services (for a brief overview of issues relating to competition, see "Introduction and background information on privately financed infrastructure projects", paras. 24-29). The consequence of such a measure, however, may be a significant erosion of the income anticipated by the project company.

57. Generally, it may be useful to authorize the Government, where appropriate, to give assurances that the project company's exclusive rights will not be unduly affected by subsequent changes in governmental policies without appropriate compensation. However, it may not be advisable to adopt statutory provisions that rule out the possibility of subsequent changes in the Government's policy for the sector concerned, including a decision to promote competition or to build parallel infrastructure. The possible consequences of such future changes for the project company should be dealt with by the parties in contractual provisions dealing with changes in circumstances (see chap. IV, "Construction and operation of infrastructure", paras. 121-130). It is particularly advisable to provide the contracting authority with the necessary power to negotiate with the project company the compensation that may be due for loss or damage that may result from a competing infrastructure project subsequently launched by the contracting authority or from any equivalent measure of the Government that adversely affects the project company's exclusive rights.

(g) Ancillary revenue sources

58. One additional form of support to the execution of privately financed infrastructure projects may be to allow the project company to diversify its investment through additional concessions for the provision of ancillary services or the exploitation of other activities. In some cases, alternative sources of revenue may also be used as a subsidy to the project company for the purpose of pursuing a policy of low or controlled prices for the main service. Provided that the ancillary activities are sufficiently profitable, they may enhance the financial feasibility of a project: the right to collect tolls on an existing bridge, for example, may be an incentive for the execution of a new toll bridge project. However, the relative importance of ancillary revenue sources should not be overemphasized.

59. In order to allow the project company to pursue ancillary activities, it may be necessary for the Government to receive legislative authorization to grant the project company the right to use property belonging to the contracting authority for the purposes of such activities (for example, land adjacent to a highway for construction of service areas) or the right to charge fees for the use of a facility built by the contracting authority. Where it is felt necessary to control the development and possibly the expansion of such ancillary activities, the approval of the contracting authority might be required in order for the project company to undertake significant expansion of facilities used for ancillary activities.

60. Under some legal systems, certain types of ancillary source of revenue offered by the Government may be regarded as a concession separate from the main concession and it is therefore advisable to review possible limitations to the project company's freedom to enter into contracts for the operation of ancillary facilities (see chap. IV, "Construction and operation of infrastructure", paras. 100 and 101).

D. GUARANTEES PROVIDED BY INTERNATIONAL FINANCIAL INSTITUTIONS

61. Besides guarantees given directly by the host Government, there may be guarantees issued by international financial institutions, such as the World Bank, the Multilateral Investment Guarantee Agency and the regional development banks. Such guarantees usually protect the project company against certain political risks, but under some circumstances they may also cover breach of the project agreement, for instance, where the project company defaults on its loans as a result of the breach of an obligation by the contracting authority.

1. Guarantees provided by multilateral lending institutions

62. In addition to lending to Governments and public authorities, multilateral lending institutions, such as the World Bank and the regional development banks, have developed programmes to extend loans to the private sector. Sometimes they can also provide guarantees to commercial lenders for public and private sector projects. In most cases, such guarantees provided by those institutions require a counter-guarantee from the host Government.

63. Guarantees by multilateral lending institutions are designed to mitigate the risks of default on sovereign contractual obligations or long-maturity loans that private lenders are not prepared to bear and are not equipped to evaluate. For instance, guarantees provided by the World Bank may typically cover specified risks (the partial risk guarantee) or all credit risks during a specified part of the financing term (the partial credit guarantee), as summarized below. Most regional development banks provide guarantees under terms similar to those of the World Bank.

(a) Partial risk guarantees

64. A partial risk guarantee covers specified risks arising from non-performance of sovereign contractual obligations or certain political force majeure events. Such guarantees ensure payment in the case of debt service default resulting from the non-performance of contractual obligations undertaken by Governments or their agencies. They may cover various types of non-performance, such as failure to maintain the agreed regulatory framework, including price formulas; failure to deliver inputs, such as fuel supplied to a private power company; failure to pay for outputs, such as power purchased by a government utility from a power company or bulk water purchased by a local public distribution company; failure to compensate for project delays or interruptions caused by government actions or political events; procedural delays; and adverse changes in exchange control laws or regulations.

65. When multilateral lending institutions participate in financing a project, they sometimes provide support in the form of a waiver of recourse that they would otherwise have to the project company in the event that default is caused by events such as political risks. For example, a multilateral lending institution taking a completion guarantee from the project company may accept that it cannot enforce that guarantee if the reason for failure to complete was a political risk reason.

(b) Partial credit guarantees

66. Partial credit guarantees are provided to private sector borrowers with a government counter-guarantee. They are designed to cover the portion of financing that falls due beyond the normal tenure of loans provided by private lenders. These guarantees are generally used for projects involving private sector participation that need long-term funds to be financially viable. A partial credit guarantee typically extends maturities of loans and covers all events of non-payment for a designated part of the debt service.

2. Guarantees provided by the Multilateral Investment Guarantee Agency

67. The Multilateral Investment Guarantee Agency (MIGA) offers long-term political risk insurance coverage to new investments originating in any member country and destined for any developing member country other than the country from which the investment originates. New investment contributions associated with the expansion, modernization or financial restructuring of existing projects are also eligible, as are acquisitions that involve the privatization of State enterprises. Eligible forms of foreign investment include equity, shareholder loans and loan guarantees issued by equity holders, provided the loans and loan guarantees have terms of at least three years. Loans to unrelated borrowers can also be insured, as long as a shareholder investment in the project is concurrently insured. Other eligible forms of investment are technical assistance, management contracts and franchising and licensing agreements, provided they have terms of at least three years and the remuneration of the investor is tied to the operating results of the project. MIGA insures against the following risks: foreign currency transfer restrictions, expropriation, breach of contract, war and civil disturbance.

(a) Transfer restrictions

68. The purpose of guarantees of foreign currency transfer extended by MIGA is similar to that of sovereign foreign exchange guarantees that may be provided by the host Government (see para. 49). This guarantee protects against losses arising from an investor's inability to convert local currency (capital, interest, principal, profits, royalties and other remittances) into foreign exchange for transfer outside the host country. The coverage insures against excessive delays in acquiring foreign exchange caused by action or failure to act by the host Government, by adverse changes in exchange control laws or regulations and by deterioration in conditions governing the conversion and transfer of local currency. Currency devaluation is not covered. On receipt of the blocked local currency from an investor, MIGA pays compensation in the currency of its contract of guarantee.

(b) Expropriation

69. This guarantee protects against loss of the insured investment as a result of acts by the host Government that may reduce or eliminate ownership of, control over or rights to the insured investment. In addition to outright nationalization and confiscation, "creeping" expropriation—a series of acts that, over time, have an expropriatory effect—is also covered. Coverage is provided on a limited basis for partial expropriation (for example, confiscation of funds or tangible assets). Bona fide, non-discriminatory

measures taken by the host Government in the exercise of legitimate regulatory authority are not covered. For total expropriation of equity investments, MIGA pays the net book value of the insured investment. For expropriation of funds, MIGA pays the insured portion of the blocked funds. For loans and loan guarantees, the Agency insures the outstanding principal and any accrued and unpaid interest. Compensation is paid upon assignment of the investor's interest in the expropriated investment (for example, equity shares or interest in a loan agreement) to MIGA.

(c) Breach of contract

70. This guarantee protects against losses arising from the host Government's breach or repudiation of a contract with the investor. In the event of an alleged breach or repudiation, the investor must be able to invoke a dispute resolution mechanism (for example, arbitration) under the underlying contract and obtain an award for damages. If, after a specified period of time, the investor has not received payment or if the dispute resolution mechanism fails to function because of actions taken by the host Government, MIGA will pay compensation.

(d) War and civil disturbance

71. This guarantee protects against loss from damage to, or the destruction or disappearance of, tangible assets caused by politically motivated acts of war or civil disturbance in the host country, including revolution, insurrection, coup d'état, sabotage and terrorism. For equity investments, MIGA will pay the investor's share of the least of the book value of the assets, their replacement cost or the cost of repair of damaged assets. For loans and loan guarantees, MIGA will pay the insured portion of the principal and interest payments in default as a direct result of damage to the assets of the project caused by war and civil disturbance. War and civil disturbance coverage also extends to events that, for a period of one year, result in an interruption of project operations essential to overall financial viability. This type of business interruption is effective when the investment is considered a total loss; at that point, MIGA will pay the book value of the total insured equity investment.

E. GUARANTEES PROVIDED BY EXPORT CREDIT AGENCIES AND INVESTMENT PROMOTION AGENCIES

72. Insurance against certain political, commercial and financial risks, as well as direct lending, may be obtained from export credit agencies and investment promotion agencies. Export credit agencies and investment promotion agencies have typically been established in a number of countries to assist in the export of goods or services originating from that country. Export credit agencies act on behalf of the Governments of the countries supplying goods and services for the project. Most export credit agencies are members of the International Union of Credit and Investment Insurers (Berne Union), whose main objectives include promoting international cooperation and fostering a favourable investment climate; developing and maintaining sound principles of export credit insurance; and establishing and sustaining discipline in the terms of credit for international trade.

73. While the support available differs from country to country, export credit agencies typically offer two lines of coverage:

(a) Export credit insurance. In the context of the financing of privately financed infrastructure projects, the essential purpose of export credit insurance is to guarantee payment to the seller whenever a foreign buyer of exported goods or services is allowed to defer payment. Export credit insurance may take the form of "supplier credit" or "buyer credit" insurance arrangements. Under the supplier credit arrangements the exporter and the importer agree on commercial terms that call for deferred payment evidenced by negotiable instruments (for example, bills of exchange or promissory notes) issued by the buyer. Subject to proof of creditworthiness, the exporter obtains insurance from an export credit agency in its home country. Under the buyer credit modality, the buyer's payment obligation is financed by the exporter's bank, which in turn obtains insurance coverage from an export credit agency. Export credits are generally classified as short-term (repayment terms of usually under two years), medium-term (usually two to five years) and long-term (over five years). Official support by export credit agencies may take the form of "pure cover", by which is meant insurance or guarantees given to exporters or lending institutions without financing support. Official support may also be given in the form of "financing support", which is defined as including direct credits to the overseas buyer, refinancing and all forms of interest rate support;

(b) Investment insurance. Export credit agencies may offer insurance coverage either directly to a borrower or to the exporter for certain political and commercial risks. Typical political and commercial risks include war, insurrection or revolution; expropriation, nationalization or requisition of assets; non-conversion of currency; and lack of availability of foreign exchange. Investment insurance provided by export credit agencies typically protects the investors in a project company established overseas against the insured risks, but not the project company itself. Investment insurance cover tends to be extended to a wide range of political risks. Export credit agencies prepared to cover such risks will typically require sufficient information on the legal system of the host country.

74. The conditions under which export credit agencies of member countries of the Organisation for Economic Cooperation and Development (OECD) offer support to both supplier and buyer credit transactions have to be in accordance with the OECD Arrangement on Guidelines for Officially Supported Export Credits (also referred to as the "OECD consensus"). The main purpose of the Arrangement is to provide a suitable institutional framework to prevent unfair competition by means of official support for export credits. In order to avoid market-distorting subsidies, the Arrangement regulates the conditions of terms of insurances, guarantees or direct lending supported by Governments.

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Chapter III. Selection of the concessionaire

CONTENTS

LEGISLATIVE RECOMMENDATIONS

For host countries wishing to promote privately financed infrastructure projects it is recommended that the following principles be implemented by the law:

General considerations (see paras. 1-33)

Recommendation 14. The law should provide for the selection of the concessionaire through transparent and efficient competitive procedures adapted to the particular needs of privately financed infrastructure projects.

Pre-selection of bidders (see paras. 34-50)

Recommendation 15. The bidders should demonstrate that they meet the pre-selection criteria the contracting authority considers appropriate for the particular project, including:

(a) Adequate professional and technical qualifications, human resources, equipment and other physical facilities as necessary to carry out all the phases of the project, namely engineering, construction, operation and maintenance;

(b) Sufficient ability to manage the financial aspects of the project and capability to sustain the financing requirements for the engineering, construction and operational phases of the project;

(c) Appropriate managerial and organizational capability, reliability and experience, including previous experience in operating public infrastructure.

Recommendation 16. The bidders should be allowed to form consortia to submit proposals, provided that each member of a pre-selected consortium may participate, either directly or through subsidiary companies, in only one bidding consortium.

Recommendation 17. The contracting authority should draw up a short list of the pre-selected bidders who will subsequently be invited to submit proposals upon completion of the pre-selection phase.

Procedure for requesting proposals (see paras. 51-84)

Single-stage and two-stage procedures (see paras. 52-58)

Recommendation 18. Upon completion of the pre-selection proceedings, the contracting authority should invite the pre-selected bidders to submit final proposals.

Recommendation 19. Notwithstanding the above, the contracting authority may use a two-stage procedure to request proposals from pre-selected bidders when it is not feasible for the contracting authority to formulate project specifications or performance indicators and contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated. Where a two-stage procedure is used, the following provisions apply:

(a) The contracting authority should first call upon the pre-selected bidders to submit proposals relating to output specifications and other characteristics of the project as well as to the proposed contractual terms;

(b) The contracting authority should convene a meeting of bidders to clarify questions concerning the initial request for proposals;

(c) Following examination of the proposals received, the contracting authority should review and, as appropriate, revise the initial project specifications and contractual terms prior to issuing a final request for proposals.

Content of the final request for proposals (see paras. 59-70)

Recommendation 20. The final request for proposals should include at least the following:

(a) General information as may be required by the bidders in order to prepare and submit their proposals;

(b) Project specifications and performance indicators, as appropriate, including the contracting authority's requirements regarding safety and security standards and environmental protection;

(c) The contractual terms proposed by the contracting authority;

(d) The criteria for evaluating the proposals, the relative weight to be accorded to each such criterion and the manner in which criteria are to be applied in the evaluation of proposals.

Clarifications and modifications (see paras. 71 and 72)

Recommendation 21. The contracting authority may, whether on its own initiative or as a result of a request for clarification by a bidder, modify the final request for proposals by issuing addenda at a reasonable time prior to the deadline for submission of proposals.

Evaluation criteria (see paras. 73-77)

Recommendation 22. The criteria for the evaluation and comparison of the technical proposals should concern the effectiveness of the proposal submitted by the bidder in meeting the needs of the contracting authority, including the following:

(a) Technical soundness;

(b) Operational feasibility;

(c) Quality of services and measures to ensure their continuity;

(d) Social and economic development potential offered by the proposals.

Recommendation 23. The criteria for the evaluation and comparison of the financial and commercial proposals may include, as appropriate:

(a) The present value of the proposed tolls, fees and other charges over the concession period;

(b) The present value of the proposed direct payments by the contracting authority, if any;

(c) The costs for design and construction activities, annual operation and maintenance costs, present value of capital costs and operating and maintenance costs;

(d) The extent of financial support, if any, expected from the Government;

(e) Soundness of the proposed financial arrangements;

(f) The extent of acceptance of the proposed contractual terms.

Submission, opening, comparison and evaluation of proposals (see paras. 78-82)

Recommendation 24. The contracting authority may establish thresholds with respect to quality, technical and commercial aspects to be reflected in the proposals in accordance with the criteria set out in the request for proposals. Proposals that fail to achieve the thresholds should be regarded as non-responsive.

Recommendation 25. Whether or not it has followed pre-selection proceedings, the contracting authority may retain the right to require the bidders to demonstrate their qualifications again in accordance with criteria and procedures set forth in the request for proposals or the pre-selec-

tion documents, as appropriate. Where pre-selection proceedings have been followed, the criteria shall be the same as those used in the pre-selection proceedings.

Final negotiations (see paras. 83 and 84)

Recommendation 26. The contracting authority should rank all responsive proposals on the basis of the evaluation criteria set forth in the request for proposals and invite for final negotiation of the project agreement the bidder that has attained the best rating. Final negotiations may not concern those terms of the contract which were stated as non-negotiable in the final request for proposals.

Recommendation 27. If it becomes apparent to the contracting authority that the negotiations with the bidder invited will not result in a project agreement, the contracting authority should inform that bidder that it is terminating the negotiations and then invite for negotiations the other bidders on the basis of their ranking until it arrives at a project agreement or rejects all remaining proposals.

Direct negotiations (see paras. 85-96)

Recommendation 28. The law should set forth the exceptional circumstances under which the contracting authority may be authorized by a higher authority to select the concessionaire through direct negotiations, such as:

(a) When there is an urgent need for ensuring continuity in the provision of the service and engaging in a competitive selection procedure would therefore be impractical;

(b) In case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount;

(c) Reasons of national defence or national security;

(d) Cases where there is only one source capable of providing the required service (for example, because it requires the use of patented technology or unique know-how);

(e) When an invitation to the pre-selection proceedings or a request for proposals has been issued but no applications or proposals were submitted or all proposals failed to meet the evaluation criteria set forth in the request for proposals and if, in the judgement of the contracting authority, issuing a new request for proposals would be unlikely to result in a project award;

(f) Other cases where the higher authority authorizes such an exception for compelling reasons of public interest.

Recommendation 29. The law may require that the following procedures be observed in direct negotiations:

(a) The contracting authority should publish a notice of the negotiation proceedings and engage in negotiations with as many companies judged capable of carrying out the project as circumstances permit;

(b) The contracting authority should establish and make known to bidders the qualification criteria and the criteria for evaluating the proposals and should determine the relative weight to be accorded to each such criterion and the manner in which criteria are to be applied in the evaluation of the proposals;

(c) The contracting authority should treat proposals in a manner that avoids the disclosure of their contents to competing bidders;

(d) Any such negotiations between the contracting authority and bidders should be confidential and one party to the negotiations should not reveal to any other person any technical, price or other commercial information relating to the negotiations without the consent of the other party;

(e) Following completion of negotiations, the contracting authority should request all bidders remaining in the proceedings to submit, by a specified date, a best and final offer with respect to all aspects of their proposals;

(f) Proposals should be evaluated and ranked according to the criteria for the evaluation of proposals established by the contracting authority.

Unsolicited proposals (see paras. 97-117)

Recommendation 30. By way of exception to the selection procedures described in legislative recommendations 14-27, the contracting authority may be authorized to handle unsolicited proposals pursuant to specific procedures established by the law for handling unsolicited proposals, provided that such proposals do not relate to a project for which selection procedures have been initiated or announced by the contracting authority.

Procedures for determining the admissibility of unsolicited proposals (see paras. 110-112)

Recommendation 31. Following receipt and preliminary examination of an unsolicited proposal, the contracting authority should inform the author, within a reasonably short period, whether or not there is a potential public interest in the project. If the project is found to be in the public interest, the contracting authority should invite the author to submit a formal proposal in sufficient detail to allow the contracting authority to make a proper evaluation of the concept or technology and determine whether the proposal meets the conditions set forth in the law and is likely to be successfully implemented on the scale of the proposed project.

Recommendation 32. The author of an 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.

Procedures for handling unsolicited proposals that do not involve proprietary concepts or technology (see paras. 113 and 114)

Recommendation 33. The contracting authority should initiate competitive selection procedures under recommendations 14-27 if it is found that the envisaged output of the project can be achieved without the use of a process, design, methodology or engineering concept for which the author of the unsolicited proposal possesses exclusive rights or if the proposed concept or technology is not truly unique or new. The author of the unsolicited proposal should be invited to participate in such proceedings and might be given a premium for submitting the proposal.

Procedures for handling unsolicited proposals involving proprietary concepts or technology (see paras. 115-117)

Recommendation 34. If it appears that the envisaged output of the project cannot be achieved without using a process, design, methodology or engineering concept for which the author of the unsolicited proposal possesses exclusive rights, the contracting authority should seek to obtain elements of comparison for the unsolicited proposal. For that purpose, the contracting authority should publish a description of the essential output elements of the proposal with an invitation for other interested parties to submit alternative or comparable proposals within a certain reasonable period.

Recommendation 35. The contracting authority may engage in negotiations with the author of the unsolicited proposal if no alternative proposals are received, subject to approval by a higher authority. If alternative proposals are submitted, the contracting authority should invite all the proponents to negotiations in accordance with the provisions of legislative recommendation 29 *(b)-(f)*.

Review procedures (see paras. 118-122)

Recommendation 36. Bidders who claim to have suffered, or who may suffer, loss or injury owing to a breach of a duty imposed on the contracting authority by the law may seek review of the contracting authority's acts in accordance with the laws of the host country.

Notice of project award (see para. 123)

Recommendation 37. The contracting authority should cause a notice of the award of the project to be published. The notice should identify the concessionaire and include a summary of the essential terms of the project agreement.

Record of selection and award proceedings (see paras. 124-130)

Recommendation 38. The contracting authority should keep an appropriate record of key information pertaining to the selection and award proceedings. The law should set forth the requirements for public access.

NOTES ON THE LEGISLATIVE RECOMMENDATIONS

A. GENERAL CONSIDERATIONS

1. The present chapter deals with methods and procedures recommended for use in the award of privately financed infrastructure projects. In line with the advice of international organizations, such as UNIDO[1] and the World Bank,[2] the *Guide* expresses a preference for the use of competitive selection procedures, rather than negotiations with bidders, while recognizing that direct negotiations might also be used, according to the legal tradition of the country concerned (see also paras. 85-88).

2. The selection procedures recommended in this chapter present some of the features of the principal method for the procurement of services under the UNCITRAL Model Law on Procurement of Goods, Construction and Services (the "UNCITRAL Model Procurement Law").[3] A number of adaptations have been introduced to take into account the particular needs of privately financed infrastructure projects, such as a clearly defined pre-selection phase. Where appropriate, this chapter refers the reader to provisions of the UNCITRAL Model Procurement Law, which may, mutatis mutandis, supplement the selection procedure described herein.

1. 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 utility enterprises. Private capital may be invested in public infrastructure through the purchase of physical assets or the shares of public utility enterprises. Such transactions are often carried out in accordance with rules governing the award of contracts for the disposition of state property. In many countries, the sale of shares of public utility enterprises requires prior legislative authorization. Disposition methods often include offering of shares on stock markets or 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 project, 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 public 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 some aspects similar to those which 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.

[1] *UNIDO BOT Guidelines*, p. 96.

[2] International Bank for Reconstruction and Development, *Procurement under IBRD and IDA Loans*, 1996, para. 3.13 *(a)*.

[3] The UNCITRAL Model Law on Procurement of Goods, Construction and Services and its accompanying Guide to Enactment were adopted by the United Nations Commission on International Trade Law at its twenty-seventh session, held in New York from 31 May to 17 June 1994.

4. This chapter deals primarily with selection procedures suitable for use in relation to infrastructure projects that 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 (that is, those referred to in para. 3 *(c)*). It does not deal specifically with other methods of selecting providers of public services through licensing or similar procedures, or of merely disposing of State property through capital increases or offerings of shares.

2. General objectives of selection procedures

5. For the award of contracts for infrastructure projects, the contracting authority may either apply methods and procedures already provided in the laws of the host country 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.

(a) Economy and efficiency

6. 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 or that offers the best commercial proposal. In most cases, economy is best achieved by means of procedures that promote competition among bidders. 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.

7. It should be noted, however, that competition does not necessarily require the participation of a large number of bidders in a given selection process. For large projects in particular, there may be reasons for the contracting authority to wish to limit the number of bidders to a manageable number (see para. 20). Provided that appropriate procedures are in place, the contracting authority can take advantage of effective competition even where the competitive base is limited.

8. 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 contracting 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 contracting authority. A country wishing to achieve the benefits of foreign participation should ensure that its relevant laws and procedures are conducive to such participation.

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 contracting authority and to participating bidders. In addition to the losses that can accrue directly to the contracting authority from inefficient selection procedures (owing, for example, 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 in the selection proceedings altogether.

(b) 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 bidders, 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. Bidders 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 which do participate in selection proceedings in which they do not have that confidence would probably 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 contracting authority.

12. To guard against corruption by government officials, including employees of the contracting authorities, the host country should have in place an effective system of sanctions. These could include sanctions of a criminal nature that would apply to unlawful acts of officials conducting the selection process and of participating bidders. Conflicts of interest should also be avoided, for instance by requiring that officials of the contracting authority, their spouses, relatives and associates abstain from owning a debt or equity interest in a company participating in a selection process or accepting to serve as a director or employee of such a company. Furthermore, the law governing the selection proceedings should obligate the contracting authority to reject offers or proposals submitted by a party who gives or agrees to give, directly or indirectly, to any current or former officer or employee of the contracting authority or other public authority a gratuity in any form, an offer of employment or any other thing or service of value, as an inducement with respect to an act or decision of or procedure followed by the contracting authority in connection with the selection proceedings. These provisions may be supplemented by other measures, such as the requirement that all companies invited to participate in the selection process undertake 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 (that is, the so-called “integrity agreement”). Also, in the procurement practices

adopted by some countries, bidders are required to guarantee that no official of the procuring entity has been or shall be admitted by the bidder to any direct or indirect benefit arising from the contract or the award thereof. Breach of such a provision typically constitutes a breach of an essential term of the contract.

13. The confidence of investors may be further fostered by adequate provisions to protect the confidentiality of proprietary information submitted by them during the selection proceedings. This should include sufficient assurances that the contracting authority will treat proposals in such a manner as to avoid the disclosure of their contents to competing bidders; that any discussions or negotiations will be confidential; and that trade or other information that bidders might include in their proposals will not be made known to their competitors.

(c) Transparency of laws and procedures

14. Transparency of laws and procedures governing the selection of the concessionaire will help to achieve a number of the policy objectives already mentioned. Transparent laws are those in which the rules and procedures to be followed by the contracting authority and by bidders are fully disclosed, are not unduly complex and are presented in a systematic and understandable way. Transparent procedures are those which enable the bidders to ascertain what procedures have been followed by the contracting authority and the basis of decisions taken by it.

15. One of the most important ways to promote transparency and accountability is to include provisions requiring that the contracting authority maintain a record of the selection proceedings (see paras. 124-130). A record summarizing key information concerning those proceedings facilitates the exercise of the right of aggrieved bidders 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 public authorities exercising an audit or control function and promote the accountability of contracting authorities to the public at large as regards the award of infrastructure projects.

16. An important corollary of the objectives of economy, efficiency, integrity and transparency is the availability of administrative and judicial procedures for the review of decisions made by the authorities involved in the selection proceedings (see paras. 118-122).

3. Special features of selection procedures for privately financed infrastructure projects

17. Generally, economy in the award of public contracts is best achieved through methods that promote competition among a range of bidders 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.

18. 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 use of competitive selection procedures in privately financed infrastructure projects has been recommended by UNIDO, which has formulated detailed practical guidance on how to structure those procedures.[1] The rules for procurement under loans provided by the World Bank also advocate the use of competitive selection procedures and provide that a concessionaire selected pursuant to bidding 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.[2]

19. It should be noted, however, that no international legislative model has thus far been specifically devised for competitive selection procedures in privately financed infrastructure projects. On the other hand, domestic laws 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 in fact revealed some limitations of traditional forms of competitive selection procedures, such as the tendering method. In view of the particular issues raised by privately financed infrastructure projects, which are briefly discussed below, it is advisable for the Government to consider adapting such procedures for the selection of the concessionaire.

(a) Range of bidders to be invited

20. The award of privately financed infrastructure projects typically involves complex, time-consuming and expensive proceedings, and the sheer scale of most infrastructure projects reduces the likelihood of obtaining proposals from a large number of suitably qualified bidders. In fact, competent bidders 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 bidders. Open tendering without a pre-selection phase is therefore usually not advisable for the award of infrastructure projects.

(b) Definition of project requirements

21. In traditional public procurement of construction works the procuring authority 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 emphasize the inputs to be provided by the contractor, that is, the contracting authority establishes clearly what is to be built, how and by what means. It is therefore common for invitations to tender for construction works to be accompanied by extensive and very detailed technical specifications of the type of works and services being procured. In those cases, the

contracting authority 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.

22. However, for many privately financed infrastructure projects, the contracting authority may envisage a different allocation of responsibilities between the public and the private sector. In those cases, after having established a particular infrastructure need, the contracting authority may prefer to leave to the private sector the responsibility for proposing the best solution for meeting such a need, subject to certain requirements that may be established by the contracting authority (for example, regulatory performance or safety requirements, sufficient evidence that the technical solutions proposed had been previously tested and satisfactorily met internationally acceptable safety and other standards). The selection procedure used by the contracting authority may thus give more emphasis to the output expected from the project (that is, the services or goods to be provided) than to technical details of the works to be performed or means to be used to provide those services.

(c) Evaluation criteria

23. For projects to be financed, owned and operated by public authorities, goods, construction works or services are typically purchased 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, with the development and operational costs being recovered from the project's own revenue. 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 contracting authority will need to consider carefully the financial and commercial feasibility of the project, the soundness of the financial arrangements proposed by the bidders 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 overruns 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. Also, the contracting authority will aim at formulating qualification and evaluation criteria that give adequate weight to the need to ensure the continuous provision of and, as appropriate, universal access to the public service concerned. Furthermore, given the usually long duration of infrastructure concessions, the contracting authority will need to satisfy itself as to the soundness and acceptability of the arrangements proposed for the operational phase and will weigh carefully the service elements of the proposals (see para. 74).

(d) Negotiations with bidders

25. Laws and regulations governing tendering proceedings often prohibit negotiations between the contracting 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 Procurement 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.

26. The situation is different in the award of privately financed infrastructure projects. The complexity and long duration of such projects makes it unlikely that the contracting authority and the selected bidder 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. This is particularly true for projects involving the development of new infrastructure where the final negotiation of the financial and security arrangements takes place only after the selection of the concessionaire. It is important, however, to ensure that these negotiations are carried out in a transparent manner and do not lead to changes to the basis on which the competition was carried out (see paras. 83 and 84).

4. Preparations for the selection proceedings

27. 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 Government plays an essential role in promoting confidence in the selection process.

(a) Appointment of the award committee

28. 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 contracting 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 bidders in the selection process.

29. Another important preparatory measure is the appointment of the independent advisers who will assist the contracting authority in the selection procedures. The contracting authority may need, at this early stage, to retain the services of independent experts or advisers to assist in establishing appropriate qualification and evaluation criteria, defining performance indicators (and, if necessary, project specifications) and preparing the documentation to be issued to bidders. Consultant services and advisers may also

be retained to assist the contracting authority in the evaluation of proposals, drafting and negotiation of the project agreement. Consultants and advisers can be particularly helpful by bringing a range of technical expertise that may not always be available in the host country's civil service, such as technical or engineering advice (for example, on technical assessment of the project or installations and technical requirements of contract); environmental advice (for example, environmental assessment and operation requirements); or financial advice (for example, on financial projections, review of financing sources, assessing the adequate ratio between debt and equity and drafting of financial information documents).

(b) Feasibility and other studies

30. As indicated earlier (see chap. I, "General legislative and institutional framework", para. 25), one of the initial steps that should be taken by the Government in relation to 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 on the feasibility and financial viability of the project. An assessment of the project's environmental impact should also ordinarily be carried out by the contracting authority as part of its feasibility studies. In some countries, it has been found useful to provide for some public participation in the preliminary assessment of the project's environmental impact and the various options available to minimize it.

31. Prior to starting the proceedings leading to the selection of a prospective concessionaire, it is advisable for the contracting authority to review and, as required, expand those initial studies. In some countries contracting 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 contracting authority with a useful tool for comparison and evaluation of proposals. The confidence of bidders will be promoted by evidence that the technical, economical and financial assumptions of the project, as well as the proposed role of the private sector, have been carefully considered by the contracting authority.

(c) Preparation of documentation

32. Selection proceedings for the award of privately financed infrastructure projects typically require the preparation of extensive documentation, including a project outline, pre-selection documents, the request for proposals, instructions for preparing proposals and a draft of the project agreement. The quality and clarity of the documents issued by the contracting authority plays a significant role in ensuring an efficient and transparent selection procedure.

33. Standard documentation prepared in sufficiently precise terms may be an important element to facilitate the negotiations between bidders and prospective lenders and investors. It may also be useful for ensuring consistency in the treatment of issues common to most projects in a given sector. 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 to achieve an 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.

B. PRE-SELECTION OF BIDDERS

34. Given the complexity of privately financed infrastructure projects the contracting authority may wish to limit the number of bidders from whom proposals will subsequently be requested only to those who satisfy certain qualification criteria. In traditional government procurement, the pre-selection proceedings may consist of the verification of certain formal requirements, such as adequate proof of technical capability or prior experience in the type of procurement, so that all bidders who meet the pre-selection criteria are automatically admitted to the tendering phase. The pre-selection proceedings for privately financed infrastructure projects, in turn, may involve elements of evaluation and selection. This may be the case, for example, where the contracting authority establishes a ranking of pre-selected bidders (see para. 48).

1. Invitation to the pre-selection proceedings

35. In order to promote transparency and competition, it is advisable that the invitation to the pre-selection proceedings be made public 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 the pre-selection proceedings is to be published. With a view to fostering participation of foreign companies and maximizing competition, the contracting authority may wish to have the invitations to the pre-selection proceedings made public 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. One possible medium for such publication is *Development Business*, published by the Department of Public Information of the United Nations Secretariat.

36. Pre-selection documents should contain sufficient information for bidders 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. The invitation to the pre-selection proceedings should, in addition to identifying the infra-

structure to be built or renovated, contain information on other essential elements of the project, such as the services to be delivered by the concessionaire, the financial arrangements envisaged by the contracting authority (for example, 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 main required terms of the project agreement to be entered into as a result of the selection proceedings.

37. In addition to that, the invitation to the pre-selection proceedings should include general information similar to the information typically provided in pre-selection documents under general rules on public procurement.[4]

2. Pre-selection criteria

38. Generally, bidders 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 necessary to carry out the project. Additional criteria that might be particularly relevant for privately financed infrastructure projects may include the ability to manage the financial aspects of the project and previous experience in operating public infrastructure or in providing services under regulatory oversight (for example, quality indicators of their past performance, size and type of previous projects carried out by the bidders); 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); capability to sustain the financing requirements for the engineering, construction and operational phases of the project (demonstrated, for instance, by evidence of the bidders' ability to provide an adequate amount of equity to the project, and sufficient evidence from reputable banks attesting the bidder's good financial standing). Qualification requirements should cover all phases of an infrastructure project, including financing management, engineering, construction, operation and maintenance, where appropriate. In addition, the bidders should be required to demonstrate that they meet such other qualification criteria as would typically apply under the general procurement laws of the host country.[5]

39. One important aspect to be considered by the contracting authority relates to the relationship between the award of one particular project and the governmental policy pursued for the sector concerned (see "Introduction and background information on privately financed infrastructure projects", paras. 21-46). Where competition is sought, the Government may be interested in ensuring that the relevant market or sector is not dominated by one enterprise (for example, that the same company does not operate more than a certain limited number of local telephone companies within a given territory). To implement such a policy and to avoid market domination by bidders who may have already been awarded a concession within a given sector of the economy, the contracting authority may wish to include in the pre-selection documents for new concessions provisions that limit the participation or prevent another award to such bidders. For purposes of transparency, it is desirable for the law to provide that, where the contracting authority reserves the right to reject a proposal on those or similar grounds, adequate notice of that circumstance must be included in the invitation to the pre-selection proceedings.

40. Qualification requirements should apply equally to all bidders. A contracting authority should not impose any criterion, requirement or procedure with respect to the qualifications of bidders that has not been set forth in the pre-selection documents. When considering the professional and technical qualifications of bidding consortia, the contracting authority should consider the individual specialization of the consortium members and assess whether the combined qualifications of the consortium members are adequate to meet the needs of all phases of the project.

3. Issues relating to the participation of bidding consortia

41. 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 members of bidding consortia should relate to the consortium as a whole as well as to its individual participants. For the purpose of facilitating the liaison with the contracting authority, it may be useful to require in the pre-selection documents that each consortium designate one of its members as a focal point for all communications with the contracting authority. It is generally advisable for the contracting authority to require that the members of bidding consortia submit a sworn statement undertaking that, if awarded the contract, they shall bind themselves jointly and severally for the obligations assumed in the name of the consortium under the project agreement. Alternatively, the contracting authority may reserve itself the right to require at a later stage that the members of the selected consortium establish an independent legal entity to carry out the project (see also chap. IV, "Construction and operation of infrastructure", paras. 12-18).

42. It is also advisable for the contracting 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

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[4]For example, instructions for preparing and submitting pre-selection applications; any documentary evidence or other information that must be submitted by bidders to demonstrate their qualifications; and the manner, place and deadline for the submission of applications (see UNCITRAL Model Procurement Law, art. 7, para. 3).

[5]For example, that they have legal capacity to enter into the project agreement; that they are not insolvent, in receivership, bankrupt or being wound up, their affairs are not being administered by a court or a judicial officer, their business activities have not been suspended and they are not the subject of legal proceedings for any of the foregoing; that they have fulfilled their obligations to pay taxes and social security contributions in the State; that they have not, and their directors or officers have not, been convicted of any criminal offence related to their professional conduct or the making of false statements or misrepresentations as to their qualifications to enter into a procurement contract within a certain period of years preceding the commencement of the selection proceedings or have not been otherwise disqualified pursuant to administrative suspension or disbarment proceedings (see UNCITRAL Model Procurement Law, art. 6, para. 1 *(b)*).

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 the pre-selection proceedings that each of the members of a qualified consortium may participate, either directly or through subsidiary companies, in only one bid for the project. A violation of this rule should cause the disqualification of the consortium and of the individual member companies.

4. Pre-selection and domestic preferences

43. The laws of some countries provide for some sort of preferential treatment for domestic entities or afford special treatment to bidders that undertake to use national goods or employ local labour. Such preferential or special treatment is sometimes provided as a material qualification requirement (for example, a minimum percentage of national participation in the consortium) or as a condition for participating in the selection procedure (for example, to appoint a local partner as a leader of the bidding consortium).

44. Domestic preferences may give rise to a variety of issues. Firstly, their use is 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. Furthermore, from the perspective of the host country it is important to weigh the expected advantages against the disadvantage of depriving the contracting authority of the possibility of obtaining better options to meet the national infrastructure needs. It is also 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 bidders or bidders who offer to procure supplies, services and products in the local market. The margin of preference technique, which is provided in article 34, paragraph 4 *(d)*, of the UNCITRAL Model Procurement Law, is more transparent than subjective qualification or evaluation criteria. Furthermore, it allows the contracting authority to favour local bidders that are capable of approaching internationally competitive standards, and it does so without simply excluding foreign competition. Where domestic preferences are envisaged, they should be announced in advance, preferably in the invitation to the pre-selection proceedings.

5. Contribution towards costs of participation in the selection proceedings

45. The price charged for the pre-selection documents should only reflect the cost of printing such documents and providing them to the bidders. It should not be used as an additional tool to limit the number of bidders. Such a practice is both ineffective and adds to the already considerable cost of participation in the pre-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, in particular when they are not familiar with the selection procedures applied in the host country.

46. Therefore, some countries authorize the contracting authority to consider arrangements for compensating pre-selected bidders if the project cannot proceed for reasons outside their control or for contributing to the costs incurred by them after the pre-selection phase, when justified in a particular case by the complexity involved and the prospect of significantly improving the quality of the competition. When such contribution or compensation is envisaged, appropriate notice should be given to potential bidders at an early stage, preferably in the invitation to the pre-selection proceedings.

6. Pre-selection proceedings

47. The contracting authority should respond to any request by a bidding consortium for clarification of the pre-selection documents that is received by the contracting authority within a reasonable time prior to the deadline for the submission of applications so as to enable the bidders to make a timely submission of their application. The response to any request that might reasonably be expected to be of interest to other bidders should, without identifying the source of the request, be communicated to all bidders to which the contracting authority provided the pre-selection documents.

48. In some countries, practical guidance on selection procedures encourages domestic contracting authorities to limit the prospective proposals to the lowest possible number sufficient to ensure meaningful competition (for example, 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. Quantitative pre-selection criteria are found to be more easily applicable and transparent than qualitative criteria involving the use of merit points. However, in devising a quantitative rating system, it is important to avoid unnecessary limitation of the contracting authority's discretion in assessing the qualifications of bidders. The contracting authority may also need to take into account the fact that the procurement guidelines of some multilateral financial institutions prohibit the use of pre-selection proceedings for the purpose of limiting the number of bidders to a predetermined number. In any event, where such a rating system is to be used, that circumstance should be clearly stated in the pre-selection documents.

49. Upon completion of the pre-selection phase, the contracting authority usually draws up a short list of the pre-selected bidders which will subsequently be invited to submit proposals. One practical problem sometimes faced by

contracting authorities concerns proposals for changes in the composition of bidding consortia during the selection proceedings. From the perspective of the contracting authority, it is generally advisable to exercise caution in respect of proposed substitutions of individual members of bidding consortia after the closing of the pre-selection phase. Changes in the composition of consortia may substantially alter the basis on which the pre-selected bidding consortia were short-listed by the contracting authority and may give rise to questions about the integrity of the selection proceedings. As a general rule, only pre-selected bidders should be allowed to participate in the selection phase, unless the contracting authority can satisfy itself that a new consortium member meets the pre-selection criteria to substantially the same extent as the retiring member of the consortium.

50. While the criteria used for pre-selecting bidders should not be weighted again at the evaluation phase, the contracting authority may wish to reserve itself the right to require, at any stage of the selection process, that the bidders again demonstrate their qualifications in accordance with the same criteria used to pre-select them.

C. PROCEDURES FOR REQUESTING PROPOSALS

51. This section discusses the procedures for requesting proposals from the pre-selected bidders. The procedures described herein are in a number of respects similar to the procedures for the solicitation of proposals under the preferred method for the procurement of services provided in the UNCITRAL Model Procurement Law, with some adaptations needed to fit the needs of contracting authorities awarding infrastructure projects.

1. Phases of the procedure

52. Following the pre-selection of bidders, it is advisable for the contracting authority to review its original feasibility study and the definition of the output and performance requirements and to consider whether a revision of those requirements is needed in the light of the information obtained during the pre-selection proceedings. At this stage, the contracting authority should have already determined whether a single or a two-stage procedure will be used to request proposals.

(a) Single-stage procedure

53. The decision between having a single or a two-stage procedure for requesting proposals will depend on the nature of the contract, on how precisely the technical requirements can be defined and whether output results (or performance indicators) are used for selection of the concessionaire. If it is deemed both feasible and desirable for the contracting authority to formulate performance indicators or project specifications to the necessary degree of precision or finality, the selection process may be structured as a single-stage procedure. In that case, after having concluded the pre-selection of bidders, the contracting authority would proceed directly to issuing a final request for proposals (see paras. 59-72).

(b) Two-stage procedure

54. There are cases, however, in which it may not be feasible for the contracting authority to formulate its requirement in sufficiently detailed and precise project specifications or performance indicators to permit proposals to be formulated, evaluated and compared uniformly on the basis of those specifications and indicators. This may be the case, for instance, when the contracting authority has not determined the type of technical and material input that would be suitable for the project in question (for example, the type of construction material to be used in a bridge). In such cases, it might be considered undesirable, from the standpoint of obtaining the best value, for the contracting authority to proceed on the basis of specifications or indicators it has drawn up in the absence of discussions with bidders as to the exact capabilities and possible variations of what is being offered. For that purpose, the contracting authority may wish to divide the selection proceedings into two stages and allow a certain degree of flexibility for discussions with bidders.

55. Where the selection procedure is divided into two stages, the initial request for proposals typically calls upon the bidders to submit proposals relating to output specifications and other characteristics of the project as well as to the proposed contractual terms. The invitation for bids would allow bidders to offer their own solutions for meeting the particular infrastructure need in accordance with defined standards of service. The proposals submitted at this stage would typically consist of solutions on the basis of a conceptual design or performance indicators without indication of financial elements, such as the expected price or level of remuneration.

56. To the extent the terms of the contractual arrangements are already known by the contracting authority, they should be included in the request for proposals, possibly in the form of a draft of the project agreement. Knowledge of certain contractual terms, such as the risk allocation envisaged by the contracting authority, is important in order for the bidders to formulate their proposals and discuss the "bankability" of the project with potential lenders. The initial response to those contractual terms, in particular the risk allocation envisaged by the contracting authority, may help the contracting authority assess the feasibility of the project as originally conceived. However, it is important to distinguish between the procedure to request proposals and the negotiation of the final contract, after the project has been awarded. The purpose of this initial stage is to enable the contracting authority to formulate its requirement subsequently in a manner that enables a final competition to be carried out on the basis of a single set of parameters. The invitation of initial proposals at this stage should not lead to a negotiation of the terms of the contract prior to its final award.

57. The contracting authority may then convene a meeting of bidders to clarify questions concerning the request for proposals and accompanying documentation. The contracting authority may, in the first stage, engage in discussions with any bidder concerning any aspect of its proposal. The contracting authority should treat proposals in such a manner as to avoid the disclosure of their contents to competing bidders. Any discussions need to be confidential and one party to the discussions should not reveal to any other person any technical, financial or other information relating to the discussions without the consent of the other party.

58. Following those discussions, the contracting authority should review and, as appropriate, revise the initial output specifications. In formulating those revised specifications, the contracting 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 bidders in the invitation to submit final proposals. Bidders not wishing to submit a final proposal should be allowed to withdraw from the selection proceedings without forfeiting any security that they may have been required to provide.

2. Content of the final request for proposals

59. At the final stage, the contracting authority should invite the bidders to submit final proposals with respect to the revised project specifications, performance indicators and contractual terms. The request for proposals should generally include all information necessary to provide a basis to enable the bidders to submit proposals that meet the needs of the contracting authority and that the contracting authority can compare in an objective and fair manner.

(a) General information to bidders

60. General information to bidders should cover, as appropriate, those items which are ordinarily included in solicitation documents or requests for proposals for the procurement of goods, construction and services.[6] Particularly important is the disclosure of the criteria to be used by the contracting authority in determining the successful proposal and the relative weight of such criteria (see paras. 73-77).

(i) Information on feasibility studies

61. It is advisable to include in the general information provided to bidders instructions for the preparation of feasibility studies they may be required to submit with their final proposals. Such feasibility studies typically cover, for instance, the following aspects:

(a) Commercial viability. In particular 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 (for example, traffic forecasts for roads) and pricing (for example, tolls);

(b) Engineering design and operational feasibility. Bidders 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. Bidders 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 bidders should be required to submit sufficient evidence of the lenders' intention to provide the specified financing. In some countries, bidders are also required to indicate the expected financial internal rate of return in relation to the effective cost of capital corresponding to the financing arrangements proposed. Such information is intended to allow the contracting authority to consider the reasonableness and affordability of the proposed prices or fees to be charged by the concessionaire and the potential for subsequent increases therein;

(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 to ensure compliance with the applicable environmental standards. Such a study should take into account, as appropriate, the relevant environmental standards of international financial institutions and of national, provincial and local authorities.

(ii) Information on bid securities

62. It is advisable for the request for proposals to indicate any requirements of the contracting authority with respect to the issuer and the nature, form, amount and other principal terms of any bid security that the bidders may be required to provide so as to cover those losses which may result from withdrawal of proposals or failure by the selected bidder to conclude a project agreement. In order to ensure fair treatment of all bidders, requirements that refer directly or indirectly to the conduct by the bidder 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 contracting authority to do so; and failure to provide required security for the fulfilment of the project agreement after the proposal has begn accepted or to com-

[6]For example, instructions for preparing and submitting proposals, including the manner, place and deadline for the submission of proposals and the period of time during which proposals shall be in effect and any requirements concerning tender securities; the means by which bidders may seek clarifications of the request for proposals, and a statement as to whether the contracting authority intends, at this stage, to convene a meeting of bidders; the place, date and time for the opening of proposals and the procedures to be followed for opening and examining proposals; and the manner in which the proposals will be evaluated (see UNCITRAL Model Procurement Law, arts. 27 and 38).

ply with any other condition prior to signing the project agreement specified in the request for proposals. Safeguards should be included to ensure that a bid security requirement is only imposed fairly and for the purpose intended.[7]

(iii) Qualification of bidders

63. Where no pre-selection of bidders was carried out prior to the issuance of the request for proposals or when the contracting authority retains the right to require the bidders to demonstrate again their qualifications, the request for proposals should set out the information that needs to be provided by the bidders to substantiate their qualifications (see paras. 38-40).

(b) Project specifications and performance indicators

64. 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 (see paras. 21 and 22). It is generally advisable for the contracting 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 to select the bidder that offers the highest quality of services at the best economic terms. The contracting authority may find it useful to formulate the project specifications in a way that defines adequately the output and performance required without being overly prescriptive in how that is to be achieved. Project specifications and performance indicators typically cover items such as the following:

(a) Description of project and expected output. If the services require specific buildings, such as a transport terminal or an airport, the contracting authority may wish to provide no more than outline planning concepts for the division of the site into usage zones on an illustrative basis, instead of plans indicating the location and size of individual buildings, as would normally be the case in traditional procurement of construction services. However, where in the judgement of the contracting authority it is essential for the bidders to provide detailed technical specifications, the request for proposals should include, at least, the following information: description of the works and services to be performed, including technical specifications, plans, drawings and designs; time schedule for the execution of works and provision of services; and the technical requirements for the operation and maintenance of the facility;

(b) Minimum applicable design and performance standards, including appropriate environmental standards. Performance standards are typically formulated in terms of the desired quantity and quality of the outputs of the facility. Proposals that deviate from the relevant performance standards should be regarded as non-responsive;

(c) Quality of services. For projects involving the provision of public services, the performance indicators should include a description of the services to be provided and the relevant standards of quality to be used by the contracting authority in the evaluation of the proposals. Where appropriate, reference should be made to any general obligations of public service providers as regards expansion and continuity of the service so as to meet the demand of the community or territory served, ensuring non-discriminatory availability of services to the users and granting non-discriminatory access of other service providers to any public infrastructure network operated by the concessionaire, under the terms and conditions established in the project agreement (see chap. IV, "Construction and operation of infrastructure", paras. 82-93).

65. Bidders should be instructed to provide the information necessary in order for the contracting authority to evaluate the technical soundness of proposals, their operational feasibility and responsiveness to standards of quality and technical requirements, including the following information:

(a) Preliminary engineering design, including proposed schedule of works;

(b) Project cost, including operating and maintenance cost requirements and proposed financing plan (for example, proposed equity contribution or debt);

(c) The proposed organization, methods and procedures for the operation and maintenance of the project under bidding;

(d) Description of quality of services.

66. Each of the above-mentioned performance indicators may require the submission of additional information by the bidders, according to the project being awarded. For the award of a concession for distribution of electricity in a specific region, for example, indicators may include minimum technical standards such as: *(a)* specified voltage (and frequency) fluctuation at consumer level; *(b)* duration of outages (expressed in hours per year); *(c)* frequency of outages (expressed in a number per year); *(d)* losses; *(e)* number of days to connect a new customer; *(f)* commercial standards for customer relationship (for example, number of days to pay bills, to reconnect installations or to respond to customers' complaints).

(c) Contractual terms

67. It is advisable for the bidding documents to provide some indication of how the contracting authority expects to allocate the project risks (see also chaps. II, "Project risks and government support", and IV, "Construction and operation of infrastructure"). This is important in order to set the terms of debate for negotiations on certain details of the

[7] Article 32 of the UNCITRAL Model Procurement Law provides certain important safeguards, including, inter alia, the requirement that the contracting 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.

project agreement (see paras. 83 and 84). If risk allocation is left entirely open, the bidders may respond by seeking to minimize the risks they accept, which may frustrate the purpose of seeking private investment for developing the project. Furthermore, the request of proposals should contain information on essential elements of the contractual arrangements envisaged by the contracting authority, such as:

(a) The duration of the concession or invitations to bidders to submit proposals for the duration of the concession;

(b) Formulas and indices to be used in adjustments to prices;

(c) Government support and investment incentives, if any;

(d) Bonding requirements;

(e) Requirements of regulatory agencies, if any;

(f) Monetary rules and regulations governing foreign exchange remittances;

(g) Revenue-sharing arrangements, if any;

(h) Indication of the categories of assets that the concessionaire would be required to transfer to the contracting authority or make available to a successor concessionaire at the end of the project period;

(i) Where a new concessionaire is being selected to operate an existing infrastructure, a description of the assets and property that will be made available to the concessionaire;

(j) The possible alternative, supplementary or ancillary revenue sources (for example, concessions for exploitation of existing infrastructure), if any, that may be offered to the successful bidder.

68. Bidders should be instructed to provide the information necessary in order for the contracting authority to evaluate the financial and commercial elements of the proposals and their responsiveness to the proposed contractual terms. The financial proposals should normally include the following information:

(a) For projects in which the concessionaire's income is expected to consist primarily of tolls, fees or charges paid by the customers or users of the infrastructure facility, the financial proposal should indicate the proposed price structure. For projects in which the concessionaire's income is expected to consist primarily of payments made by the contracting authority or another public authority to amortize the concessionaire's investment, the financial proposal should indicate the proposed amortization payments and repayment period;

(b) The present value of the proposed prices or direct payments based on the discounting rate and foreign exchange rate prescribed in the bidding documents;

(c) If it is estimated that the project would require financial support by the Government, the level of such support, including, as appropriate, any subsidy or guarantee expected from the Government or the contracting authority;

(d) The extent of risks assumed by the bidders during the construction and operation phase, including unforeseen events, insurance, equity investment and other guarantees against those risks.

69. In order to limit and establish clearly the scope of the negotiations that will take place following the evaluation of proposals (see paras. 83 and 84), the final request for proposals should indicate which are the terms of the project agreement that are deemed not negotiable.

70. It is useful for the contracting authority to require that the final proposals submitted by the bidders contain evidence showing the comfort of the bidder's main lenders with the proposed commercial terms and allocation of risks, as outlined in the request for proposals. Such a requirement might play a useful role in resisting pressures to reopen commercial terms at the stage of final negotiations. In some countries, bidders are required to initial and return to the contracting 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.

3. Clarifications and modifications

71. The right of the contracting 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 therefore advisable to authorize the contracting authority, whether on its own initiative or as a result of a request for clarification by a bidder, to modify the request for proposals by issuing an addendum at any time prior to the deadline for submission of proposals. However, when amendments are made that would reasonably require bidders to spend additional time preparing their proposals, such additional time should be granted by extending the deadline for submission of proposals accordingly.

72. Generally, clarifications, together with the questions that gave rise to the clarifications, and modifications must be communicated promptly by the contracting authority to all bidders to whom the contracting authority provided the request for proposals. If the contracting authority convenes a meeting of bidders, it should prepare minutes of the meeting containing the requests submitted at the meeting for clarification of the request for proposals and its responses to those requests and should send copies of the minutes to the bidders.

4. Evaluation criteria

73. The award committee should rate the technical and financial elements of each proposal in accordance with the predisclosed rating systems for the technical evaluation criteria and should specify in writing the reasons for its rating. Generally, it is important for the contracting authority to achieve an appropriate balance between evaluation criteria relating to the physical investment (for example, the construction works) and evaluation criteria relating to the operation and maintenance of the infrastructure and the quality of services to be provided by the concessionaire. Adequate emphasis should be given to the long-term needs of the contracting authority, in particular the need to ensure the continuous delivery of the service at the required level of quality and safety.

(a) Evaluation of technical aspects of the proposals

74. Technical evaluation criteria are designed to facilitate the assessment of the technical, operational, environmental and financing viability of the proposal vis-à-vis the prescribed specifications, indicators and requirements prescribed in the bidding documents. To the extent practicable, the technical criteria applied by the contracting 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. Technical proposals for privately financed infrastructure projects are usually evaluated in accordance with the following criteria:

(a) Technical soundness. Where the contracting authority has established minimum engineering design and performance specifications or standards, the basic design of the project should conform to those specifications or standards. Bidders should be required to demonstrate the soundness of the proposed construction methods and schedules;

(b) Operational feasibility. The proposed organization, methods and procedures for operating and maintaining the completed facility must be well defined, should conform to the prescribed performance standards and should be shown to be workable;

(c) Quality of services. Evaluation criteria used by the contracting authority should include an analysis of the manner in which the bidders undertake to maintain and expand the service, including the guarantees offered for ensuring its continuity;

(d) Environmental standards. The proposed design and the technology of the project to be used should be in accordance with the environmental standards set forth in the request for proposals. Any negative or adverse effects on the environment as a consequence of the project as proposed by the bidders should be properly identified, including the corresponding corrective or mitigating measures;

(e) Enhancements. These may include other terms the author of the project may offer to make the proposals more attractive, such as revenue-sharing with the contracting authority, fewer governmental guarantees or reduction in the level of government support;

(f) Potential for social and economic development. Under this criterion, the contracting authority may take into account the potential for social and economic development offered by the bidders, including benefits to underprivileged groups of persons and businesses, domestic investment or other business activity, the encouragement of employment, the reservation of certain production for domestic suppliers, the transfer of technology and the development of managerial, scientific and operational skills;

(g) Qualification of bidders. When no pre-selection was made by the contracting authority prior to the issuance of the request for proposals, the contracting authority should not accept a proposal if the bidders that submitted the proposals are not qualified.

(b) Evaluation of financial and commercial aspects of the proposals

75. In addition to criteria for the technical evaluation of proposals, the contracting authority needs to define criteria for assessing and comparing the financial proposals. For projects in which the concessionaire's income is expected to consist primarily of tolls, fees or charges paid by the customers or users of the infrastructure facility, the assessment and comparison of the financial elements of the final proposals is typically based on the present value of the proposed tolls, fees, rentals and other charges over the concession period according to the prescribed minimum design and performance standards. For projects in which the concessionaire's income is expected to consist primarily of payments made by the contracting authority to amortize the concessionaire's investment, the assessment and comparison of the financial elements of the final proposals is typically based on the present value of the proposed schedule of amortization payments for the facility to be constructed according to the prescribed minimum design and performance standards, plans and specifications.

76. However, the contracting authority's assessment of financial elements of the final proposals should not be limited to a comparison of the unit prices offered for the expected output. In order to consider adequately the financial feasibility of the proposals and the likelihood of subsequent increases in the proposed prices, additional criteria may need to be considered, such as the costs for design and construction activities; annual operation and maintenance costs; present value of capital costs and operating costs; and the amount of subsidy, if any, expected from the Government. The contracting authority should assess whether the proposed financing plan, including the proposed ratio between equity investment and debt, is adequate to meet the construction, operating and maintenance costs of the project.

77. In establishing the criteria for the evaluation of financial proposals, it is important for the contracting authority to consider carefully the relative importance of the proposed unit price for the expected output as an evaluation criterion. While the unit price is an important factor for ensuring objectiveness and transparency in the choice between equally responsive proposals, it should be noted that the notion of "price" usually does not have the same value for the award of privately financed infrastructure projects as it has in the procurement of goods and services. Indeed, the remuneration of the concessionaire is 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. Therefore, while the unit price for the expected output retains its role as an important element of comparison of proposals, it may not always be regarded as the most important factor.

5. Submission, opening, comparison and evaluation of proposals

78. Proposals should be required to be submitted in writing, signed and placed in sealed envelopes. A proposal

received by the contracting authority after the deadline for the submission of proposals should not be opened and should be returned to the bidder that submitted it. 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 bidders that have submitted proposals, or their representatives, be permitted by the contracting authority to be present at the opening of proposals. Such a requirement helps to minimize the risk that the proposals might be altered or otherwise tampered with and represents an important guarantee of the integrity of the proceedings.

79. In view of the complexity of privately financed infrastructure projects and the variety of evaluation criteria usually applied in the award of the project, it may be advisable for the contracting authority to apply a two-step evaluation process whereby non-financial criteria would be taken into consideration separately from, and perhaps before, financial criteria so as to avoid situations where undue weight would be given to certain elements of the financial criteria (such as the unit price) to the detriment of the non-financial criteria.

80. To that end, in some countries bidders are required to formulate and submit their technical and financial proposals in two separate envelopes. The two-envelope system is sometimes used because it permits the contracting authority to evaluate the technical quality of proposals without being influenced by their financial components. However, the method has been criticized as being contrary to the objective of economy in the award of public contracts. In particular, there is said to be a danger that, by selecting proposals initially on the basis of technical merit alone and without reference to price, a contracting authority might be tempted to select, upon the opening of the first envelope, proposals offering technically superior works and to reject proposals offering less sophisticated solutions that nevertheless meet the contracting authority's needs at an overall lower cost. International financial institutions, such as the World Bank, do not accept the two-envelope system for projects financed by them because of concerns that the system gives margin to a higher degree of discretion in the evaluation of proposals and makes it more difficult to compare them in an objective manner.

81. As an alternative to the use of a two-envelope system, the contracting authorities may require both technical and financial proposals to be contained in one single proposal, but structure their evaluation in two stages, as in the evaluation procedure provided in article 42 of the UNCITRAL Model Procurement Law. At an initial stage, the contracting authority typically establishes a threshold with respect to quality and technical aspects to be reflected in the technical proposals in accordance with the criteria as set out in the request for 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 contracting authority then compares the financial and commercial proposals that have attained a rating at or above the threshold. When the technical and financial proposals are to be evaluated consecutively, the contracting authority should initially ascertain whether the technical proposals are prima facie responsive to the request for proposals (that is, whether they cover all items required to be addressed in the technical proposals). Incomplete proposals, as well as proposals that deviate from the request for proposals, should be rejected at this stage. While the contracting authority may ask bidders for clarifications of their proposals, no change in a matter of substance in the proposal, including changes aimed at making a non-responsive proposal responsive, should be sought, offered or permitted at this stage.

82. In addition to deciding whether to use a two-envelope system or a two-stage evaluation procedure, it is important for the contracting authority to disclose the relative weight to be accorded to each evaluation criterion and the manner in which criteria are to be applied in the evaluation of proposals. Two possible approaches might be used to reach an appropriate balance between financial and technical aspects of the proposals. One possible approach is to consider as most advantageous the proposal that obtains the highest combined rating in respect of both price and non-price evaluation criteria. Alternatively, the price proposed for the output (for example, the water or electricity price or the level of tolls) might be the deciding factor in establishing the winning proposal among the responsive proposals (that is, those which have passed the threshold with respect to quality and technical aspects). In any event, 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 written reasons for selecting a proposal other than the one offering the lowest unit price for the output.

6. Final negotiations and project award

83. The contracting authority should rank all responsive proposals on the basis of the evaluation criteria set forth in the request for proposals and invite the best rated bidder for final negotiation of certain elements of the project agreement. The final negotiations should be limited to fixing the final details of the transaction documentation and satisfying the reasonable requirements of the selected bidder's lenders. One particular problem faced by contracting authorities is the danger that the negotiations with the selected bidder might lead to pressures to amend, to the detriment of the Government or the consumers, 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 which were deemed not negotiable in the final request for proposals (see para. 69). The risk of reopening commercial terms at this late stage could be further minimized by insisting that the selected bidder's lenders indicate their comfort with the risk allocation embodied in their bid at a stage where there is competition among bidders (see para. 70). The contracting authority's financial advisers might contribute to this process by advising whether bidders' proposals are realistic and what levels of financial commitment are appropriate at each stage. The process of reaching financial close can itself be quite lengthy.

84. The contracting authority should inform the remaining responsive bidders that they may be considered for negotiation if the negotiations with the bidder with better ratings do not result in a project agreement. If it becomes apparent to the contracting authority that the negotiations with the invited bidder will not result in a project agreement, the contracting authority should inform that bidder that it is terminating the negotiations and then invite for negotiations the next bidder 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 contracting authority should not reopen negotiations with any bidder with whom they have already been terminated.

D. DIRECT NEGOTIATIONS

85. In the legal tradition of certain countries, privately financed infrastructure projects involve the delegation by the contracting authority of the right and duty to provide a public service. As such, they are subject to a special legal regime that differs in many respects from the regime that applies generally to the award of public contracts for the purchase of goods, construction or services.

86. Given the very particular nature of the services required (including their complexity, amount of investment involved and completion time), the procedures used place the accent on the contracting authority's freedom to choose the operator who best suits 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. In contrast to the competitive selection procedures usually followed for the award of public contracts, which sometimes may appear to be excessively rigid, selection by direct negotiation is characterized by a high degree of flexibility as to the procedures involved and discretion on the part of the contracting authority. However, freedom of negotiation does not mean arbitrary choice and the laws of those countries provide procedures to ensure transparency and fairness in the conduct of the selection process.

87. In those countries where tendering is under normal circumstances the rule for public procurement of goods, construction and services, guidelines issued to contracting authorities advise the use of 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 bidders the Government is not bound by predetermined requirements or rigid specifications and has more flexibility for taking advantage of innovative or alternative proposals that may be submitted by the bidders 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.

88. Direct negotiations generally afford a high degree of flexibility that some countries have found beneficial to the selection of the concessionaire. Coupled with appropriate measures to ensure transparency, integrity and fairness, direct negotiations carried out in those countries have led to satisfactory results. However, direct negotiations 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 contracting authority, direct negotiations require highly skilled personnel with sufficient experience in negotiating complex projects. They also require a well structured negotiating team, clear lines of authority and a high level of coordination and cooperation among all the offices involved. The use of direct negotiations for the award of privately financed infrastructure projects may therefore 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 direct negotiations 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 direct negotiations might carry with it a higher risk of abusive or corrupt practices. In view of the above, the host country may wish to prescribe the use of competitive selection procedures as a rule for the award of privately financed infrastructure projects and to reserve direct negotiations only for exceptional cases.

1. Circumstances authorizing the use of direct negotiations

89. For purposes of transparency as well as for ensuring discipline in the award of projects, it might be generally desirable for the law to identify the exceptional circumstances under which the contracting authority may be authorized to select the concessionaire through direct negotiations. They may include, for example, 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 contracting authority nor the result of dilatory conduct on its part. Such an exceptional authorization may be needed, for instance, in cases of interruption in the provision of a given service or where an incumbent concessionaire fails to provide the service at acceptable standards or if the project agreement is rescinded by the contracting authority, when engaging in a competitive selection procedure would be impractical in view of the urgent need to ensure the continuity of the service;

(b) In the case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount;

(c) Reasons of national defence or security;

(d) Cases where there is only one source capable of providing the required service (for example, because it can be provided only by the use of patented technology or unique know-how);

(e) When an invitation to the pre-selection proceedings or a request for proposals has been issued, but no applications or proposals were submitted or all proposals were rejected and, in the judgement of the contracting authority,

issuing a new request for proposals would be unlikely to result in a project award. However, in order to reduce the risk of abuse in changing the selection method, the contracting authority should only be authorized to resort to direct negotiations when such a possibility was expressly provided for in the original request for proposals.

2. Measures to enhance transparency in direct negotiations

90. Procedures to be followed in procurement through negotiation are typically characterized by a higher degree of flexibility than the procedures applied to other methods of procurement. Few rules and procedures are established to govern the process by which the parties negotiate and conclude their contract. In some countries, procurement laws allow contracting authorities virtually unrestricted freedom to conduct negotiations as they see fit. The laws of other countries establish a procedural framework for negotiation designed to maintain fairness and objectivity and to bolster competition by encouraging participation of bidders. Provisions on procedures for selection through negotiation address a variety of issues discussed below, in particular, requirements for approval of the contracting authority's decision to select the concessionaire through negotiation, selection of negotiating partners, criteria for comparison and evaluation of offers, and recording of the selection proceedings.

(a) Approval

91. A threshold requirement found in many countries is that a contracting authority must obtain the approval of a higher authority prior to engaging in selection through negotiation. Such provisions generally require the application for approval to be in writing and to set forth the grounds necessitating the use of negotiation. Approval requirements are intended, in particular, to ensure that the negotiation method of selection is used only in appropriate circumstances.

(b) Selection of negotiating partners

92. In order to make the negotiation proceedings as competitive as possible, it is advisable to require the contracting authority to engage in negotiations with as many companies judged susceptible of meeting the need as circumstances permit. Beyond such a general provision, there is no specific provision in the laws of some countries on the minimum number of contractors or suppliers with whom the contracting authority is to negotiate. The laws of some other countries, however, require the contracting authority, where practicable, to negotiate with, or to solicit proposals from, a minimum number of bidders (three, for example). The contracting authority is permitted to negotiate with a smaller number in certain circumstances, in particular, when fewer than the minimum number of contractors or suppliers were available.

93. For the purpose of enhancing transparency, it is also advisable to require a notice of the negotiation proceedings to be given to bidders in a specified manner. For example, the contracting authority may be required to publish the notice in a particular publication normally used for that purpose. Such notice requirements are intended to bring the procurement proceedings to the attention of a wider range of bidders than might otherwise be the case, thereby promoting competition. Given the magnitude of most infrastructure projects, the notice should normally contain certain minimum information (a description of the project, for example, or qualification requirements) and should be issued in sufficient time to allow bidders to prepare offers. Generally the formal eligibility requirements applicable to bidders in competitive selection proceedings should also apply in negotiation proceedings.

94. In some countries, notice requirements are waived when the contracting authority resorts to negotiation following unsuccessful bidding proceedings (see para. 89 *(e)*), if all qualified contractors or suppliers that submitted bids are permitted to participate in the negotiations or if no bids at all were received.

(c) Criteria for comparison and evaluation of offers

95. Another useful measure to enhance the transparency and effectiveness of direct negotiations consists of establishing general criteria that proposals are requested to meet (for example, general performance objectives or output specifications), as well as criteria for comparing and evaluating offers made during the negotiations and for selecting the winning concessionaire (for example, the technical merit of an offer, prices, operating and maintenance costs and the profitability and development potential of the project agreement). The contracting authority should identify the proposals that appear to meet those criteria and engage 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 contracting authority. The price of each proposal does not enter into those discussions. When the proposals have been finalized, it may be advisable for the contracting authority to seek a best and final offer on the basis of the clarified proposals. It is recommendable that bidders should include with their final offer evidence that the risk allocation that the offer embodies would be acceptable to their proposed lenders. From the best and final offers received, the preferred bidder can then be chosen. The project would then be awarded to the party offering the "most economical" or "most advantageous" proposal in accordance with the criteria for selecting the winning concessionaire set forth in the invitation to negotiate. It is recommended that the contracting authority's intention to seek a best and final offer or not should be stated in the invitation to negotiate.

(d) Record of selection proceedings

96. The contracting authority should be required to establish a record of the selection proceedings (see paras. 124-130) and should publish a notice of the award of the project (see para. 123). In some countries, transparency is further enhanced by requiring that the project agreement be opened to public inspection.

E. UNSOLICITED PROPOSALS

97. Public authorities are sometimes approached directly by private companies who submit proposals for the development of projects in respect of which no selection procedures have been opened. These proposals are usually referred to as "unsolicited proposals". Unsolicited proposals may result from the identification by the private sector of an infrastructure need that may be met by a privately financed project. They may also involve innovative proposals for infrastructure management and offer the potential for transfer of new technology to the host country.

1. Policy considerations

98. One possible reason sometimes cited for waiving the requirement of competitive selection procedures is to provide an incentive for the private sector to submit proposals involving the use of new concepts or technologies to meet the contracting authority's needs. By the very nature of competitive selection procedures, no bidder has an assurance of being awarded the project, unless it wins the competition. The cost of formulating proposals for large infrastructure projects may be a deterrent for companies concerned about their ability to match proposals submitted by competing bidders. In contrast, the private sector may see an incentive for the submission of unsolicited proposals in rules that allow a contracting authority to negotiate such proposals directly with their authors. The contracting authority, too, may have an interest in the possibility of engaging in direct negotiations in order to stimulate the private sector to formulate innovative proposals for infrastructure development.

99. At the same time, however, the award of projects pursuant to unsolicited proposals and without competition from other bidders may expose the Government to serious criticism, in particular in cases involving exclusive concessions. In addition, prospective lenders, including multilateral and bilateral financial institutions, may have difficulty in lending or providing guarantees for projects that have not been the subject of competitive selection proceedings. They may fear the possibility of challenge and cancellation by future Governments (for example, because the project award may be deemed subsequently to have been the result of favouritism or because the procedure did not provide objective parameters for comparing prices, technical elements and the overall effectiveness of the project) or legal or political challenge by other interested parties, such as customers dissatisfied with increased prices or competing companies alleging unjust exclusion from a competitive selection procedure.

100. In view of the above considerations, it is important for the host country to consider the need for, and the desirability of, devising special procedures for handling unsolicited proposals that differ from the procedures usually followed for the award of privately financed infrastructure projects. For that purpose, it may be useful to analyse two situations most commonly mentioned in connection with unsolicited proposals, namely, unsolicited proposals claiming to involve the use of new concepts or technologies to address the contracting authority's infrastructure needs and unsolicited proposals claiming to address an infrastructure need not already identified by the contracting authority.

(a) Unsolicited proposals claiming to involve the use of new concepts or technologies to address the contracting authority's infrastructure needs

101. Generally, for infrastructure projects that require the use of some kind of industrial process or method, the contracting authority would have an interest in stimulating the submission of proposals incorporating the most advanced processes, designs, methodologies or engineering concepts with demonstrated ability to enhance the project's outputs (by significantly reducing construction costs, for example, accelerating project execution, improving safety, enhancing project performance, extending economic life, reducing costs of facility maintenance and operations or reducing negative environmental impact or disruptions during either the construction or the operational phase of the project).

102. The contracting authority's legitimate interests might also be achieved through appropriately modified competitive selection procedures instead of a special set of rules for handling unsolicited proposals. For instance, if the contracting authority is using selection procedures that emphasize the expected output of the project, without being prescriptive about the manner in which that output is to be achieved (see paras. 64-66), the bidders would have sufficient flexibility to offer their own proprietary processes or methods. In such a situation, the fact that each of the bidders has its own proprietary processes or methods would not pose an obstacle to competition, provided that all the proposed methods are technically capable of generating the output expected by the contracting authority.

103. Adding the necessary flexibility to the competitive selection procedures may in these cases be a more satisfactory solution than devising special non-competitive procedures for dealing with proposals claiming to involve new concepts or technologies. With the possible exception of proprietary concepts or technologies whose uniqueness may be ascertained on the basis of the existing intellectual property rights, a contracting authority may face considerable difficulties in defining what constitutes a new concept or technology. Such a determination may require the services of costly independent experts, possibly from outside the host country, to avoid allegations of bias. A determination that a project involves a novel concept or technology might also be met by claims from other interested companies also claiming to have appropriate new technologies.

104. However, a somewhat different situation may arise if the uniqueness of the proposal or its innovative aspects are such that it would not be possible to implement the project without using a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights, either worldwide or regionally. The existence of intellectual property rights in relation to a method or technology may indeed reduce or eliminate the scope for meaningful competition. This is why the procurement laws of most countries authorize procuring entities to engage in

single-source procurement if the goods, construction or services are available only from a particular supplier or contractor or if the particular supplier or contractor has exclusive rights over the goods, construction or services and no reasonable alternative or substitute exists (see the UNCITRAL Model Procurement Law, art. 22).

105. In such a case, it would be appropriate to authorize the contracting authority to negotiate the execution of the project directly with the proponent of the unsolicited proposal. The difficulty, of course, would be how to establish, with the necessary degree of objectivity and transparency, that there exists no reasonable alternative or substitute to the method or technology contemplated in the unsolicited proposal. For that purpose, it is advisable for the contracting authority to establish procedures for obtaining elements of comparison for the unsolicited proposal.

(b) Unsolicited proposals claiming to address an infrastructure need not already identified by the contracting authority

106. The merit of unsolicited proposals of this type consists of the identification of a potential for infrastructure development that has not been considered by the authorities of the host country. However, in and of itself this circumstance should not normally provide sufficient justification for a directly negotiated project award in which the contracting authority has no objective assurance that it has obtained the most advantageous solution for meeting its needs.

2. Procedures for handling unsolicited proposals

107. In the light of the above considerations, it is advisable for the contracting authority to establish transparent procedures for determining whether an unsolicited proposal meets the required conditions and whether it is in the contracting authority's interest to pursue it.

(a) Restrictions to the receivability of unsolicited proposals

108. In the interest of ensuring proper accountability for public expenditures, some domestic laws provide that no unsolicited proposal may be considered if the execution of the project would require significant financial commitments from the contracting authority or other public authority such as guarantees, subsidies or equity participation. The reason for such a limitation is that the procedures for handling unsolicited proposals are typically less elaborate than ordinary selection procedures and may not ensure the same level of transparency and competition that would otherwise be achieved. However, there may be reasons for allowing some flexibility in the application of this condition. In some countries, the presence of government support other than direct government guarantees, subsidy or equity participation (for example, the sale or lease of public property to authors of project proposals) does not necessarily disqualify a proposal from being treated and accepted as an unsolicited proposal.

109. Another condition for consideration of an unsolicited proposal is that it should relate to a project for which no selection procedures have been initiated or announced by the contracting authority. The rationale for handling an unsolicited proposal without using a competitive selection procedure is to provide an incentive for the private sector to identify new or unanticipated infrastructure needs or to formulate innovative proposals for meeting those needs. This justification may no longer be valid if the project has already been identified by the authorities of the host country and the private sector is merely proposing a technical solution different from the one envisaged by the contracting authority. In such a case, the contracting authority could still take advantage of innovative solutions by applying a two-stage selection procedure (see paras. 54-58). However, it would not be consistent with the principle of fairness in the award of public contracts to entertain unsolicited proposals outside selection proceedings already started or announced.

(b) Procedures for determining the admissibility of unsolicited proposals

110. A company or group of companies that approaches the Government with a suggestion for private infrastructure development should be requested to submit an initial proposal containing sufficient information to allow the contracting authority to make a prima facie assessment of whether the conditions for handling unsolicited proposals are met, in particular whether the proposed project is in the public interest. The initial proposal should include, for instance, the following information: statement of the author's previous project experience and financial standing; description of the project (type of project, location, regional impact, proposed investment, operational costs, financial assessment and resources needed from the Government or third parties); the site (ownership and whether land or other property will have to be expropriated); and a description of the service and the works.

111. Following a preliminary examination, the contracting authority should inform the company, within a reasonably short period, whether or not there is a potential public interest in the project. If the contracting authority 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, should contain a technical and economical feasibility study (including characteristics, costs and benefits) and an environmental impact study. Furthermore, the author of the proposal should be required to submit satisfactory information regarding the concept or technology contemplated in the proposal. The information disclosed should be in sufficient detail to allow the contracting authority to evaluate the concept or technology properly and to determine whether it meets the required conditions and is likely to be successfully implemented on the scale of the proposed project. 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.

112. Once all the required information is provided by the author of the proposal, the contracting authority should

decide, within a reasonably short period, whether it intends to pursue the project and, if so, what procedure will be used. Choice of the appropriate procedure should be made on the basis of the contracting authority's preliminary determination as to whether or not the implementation of the project would be possible without the use of a process, design, methodology or engineering concept for which the proposing company or its partners possess exclusive rights.

(c) Procedures for handling unsolicited proposals that do not involve proprietary concepts or technology

113. If the contracting authority, upon examination of an unsolicited proposal, decides that there is public interest in pursuing the project, but the implementation of the project is possible without the use of a process, design, methodology or engineering concept for which the proponent or its partners possess exclusive rights, the contracting authority should be required to award the project by using the procedures that would normally be required for the award of privately financed infrastructure projects, such as, for instance, the competitive selection procedures described in this *Guide* (see paras. 34-84). However, the selection procedures may include certain special features so as to provide an incentive to the submission of unsolicited proposals. These incentives may consist of the following measures:

(a) The contracting authority could undertake not to initiate selection proceedings regarding a project in respect of which an unsolicited proposal was received without inviting the company that submitted the original proposal;

(b) The original bidder might be given some form of premium for submitting the proposal. In some countries that use a merit-point system for the evaluation of financial and technical proposals the premium takes the form of a margin of preference over the final rating (that is, a certain percentage over and above the final combined rating obtained by that company in respect of both financial and non-financial evaluation criteria). One possible difficulty of such a system is the risk of setting the margin of preference so high as to discourage competing meritorious bids, thus resulting in the receipt of a project of lesser value in exchange for the preference given to the innovative bidder. Alternative forms of incentives may include the reimbursement, in whole or in part, of the costs incurred by the original author in the preparation of the unsolicited proposal. For purposes of transparency, any such incentives should be announced in the request for proposals.

114. Notwithstanding the incentives that may be provided, the author of the unsolicited proposal should generally be required to meet essentially the same qualification criteria as would be required of the bidders participating in a competitive selection proceedings (see paras. 38-40).

(d) Procedures for handling unsolicited proposals involving proprietary concepts or technology

115. If it appears that the innovative aspects of the proposal are such that it would not be possible to implement the project without using a process, design, methodology or engineering concept for which the author or its partners possess exclusive rights, either worldwide or regionally, it may be useful for the contracting authority to confirm that preliminary assessment by applying a procedure for obtaining elements of comparison for the unsolicited proposal. One such procedure may consist of the publication of a description of the essential output elements of the proposal (for example, the capacity of the infrastructure facility, quality of the product or the service or price per unit) with an invitation to other interested parties to submit alternative or comparable proposals within a certain period. Such a description should not include input elements of the unsolicited proposal (the design of the facility, for example, or the technology and equipment to be used), in order to avoid disclosing to potential competitors proprietary information of the person who had submitted the unsolicited proposal. The period for submitting proposals should be commensurate with the complexity of the project and should afford the prospective competitors sufficient time to formulate their proposals. This may be a crucial factor for obtaining alternative proposals, for example, if the bidders would have to carry out detailed subsurface geological investigations that might have been carried out over many months by the original bidder, who would want the geological findings to remain secret.

116. The invitation for comparative or competitive proposals should be published with a minimum frequency (for example, once every week for three weeks) in at least one newspaper of general circulation. It should indicate the time and place where bidding documents may be obtained and should specify the time during which proposals may be received. It is important for the contracting authority to protect the intellectual property rights of the original author and to ensure the confidentiality of proprietary information received with the unsolicited proposal. Any such information should not form part of the bidding documents. Both the original bidder and any other company that wishes to submit an alternative proposal should be required to submit a bid security (see para. 62). Two possible avenues may then be pursued, according to the reactions received to the invitation:

(a) If no alternative proposals are received, the contracting authority may reasonably conclude that there is no reasonable alternative or substitute to the method or technology contemplated in the unsolicited proposal. This finding of the contracting authority should be appropriately recorded and the contracting authority could be authorized to engage in direct negotiations with the original proponent. It may be advisable to require that the decision of the contracting authority be reviewed and approved by the same authority whose approval would normally be required in order for the contracting authority to select a concessionaire through direct negotiation (see para. 89). Some countries whose laws mandate the use of competitive procedures have used these procedures in order to establish the necessary transparency required to avoid future challenges to the award of a concession following an unsolicited proposal. In those countries, the mere publication of an invitation to bid would permit an award to the bidder who originally submitted the unsolicited proposal, even if its bid were the only one received. This is so because compliance with competitive procedures typically requires that the possibility of competition should have been present and not

necessarily that competition actually occurred. Publicity creates such a possibility and adds a desirable degree of transparency;

(b) If alternative proposals are submitted, the contracting authority should invite all the bidders to negotiations with a view to identifying the most advantageous proposal for carrying out the project (see paras. 90-96). In the event that the contracting authority receives a sufficiently large number of alternative proposals, which appear prima facie to meet its infrastructure needs, there may be scope for engaging in full-fledged competitive selection procedures (see paras. 34-84), subject to any incentives that may be given to the author of the original proposal (see para. 113 *(b)*).

117. The contracting authority should be required to establish a record of the selection proceedings (paras. 124-130) and to publish a notice of the award of the project (see para. 123).

F. REVIEW PROCEDURES

118. The existence of fair and efficient review procedures is one of the basic requirements for attracting serious and competent bidders and for reducing the cost and the length of award proceedings. An important safeguard of proper adherence to the rules governing the selection procedure is that bidders have the right to seek review of actions by the contracting authority in violation of those rules or of the rights of bidders. Various remedies and procedures are available in different legal systems and systems of administration, which are closely linked to the question of review of governmental actions. Whatever the exact form of review procedures, it is important to ensure that an adequate opportunity and effective procedures for review are provided. It is particularly useful to establish a workable "pre-contract" recourse system (that is, procedures for reviewing the contracting authority's acts as early in the selection proceedings as feasible). Such a system increases the possibility of taking corrective actions by the contracting authority before loss is caused and helps to reduce cases where monetary compensation is the only option left to redress the consequences of an improper action by the contracting authority. Elements for the establishment of an adequate review system are contained in chapter VI of the UNCITRAL Model Procurement Law.

119. Appropriate review procedures should establish in the first place that bidders have a right to seek review of decisions affecting their rights. In the first instance, that review may be sought from the contracting authority itself, in particular where the project is yet to be awarded. This may facilitate economy and efficiency, since in many cases, in particular prior to the awarding of the project, the contracting authority may be quite willing to correct procedural errors, of which it may even not have been aware. It may also be useful to provide for a review by higher administrative organs of the Government, where such a procedure would be consistent with constitutional, judicial and administrative structures. Finally, most domestic procurement regimes affirm the right to judicial review, which should generally also be available in connection with the award of infrastructure projects.

120. In order to strike a workable balance between, on the one hand, the need to preserve the rights of bidders and the integrity of the selection process and, on the other, the need to limit disruption of the selection process, domestic laws often include a number of restrictions on review procedures. These include limitation of the right to review to bidders; time limits for filing of applications for review and for disposition of cases, including time limits for any suspension of the selection proceedings that may apply at the level of administrative review; and exclusion from the review procedures of a number of decisions that are left to the discretion of the contracting authority and that do not directly involve questions of the fairness of treatment accorded to bidders. In most legal systems, administrative review procedures are available to bidders to challenge decisions by contracting authorities, although judicial review procedures may not be universally available.

121. There exist in most States mechanisms and procedures for review of acts of administrative organs and other public entities. In some States, review mechanisms and procedures have been established specifically for disputes arising in the context of procurement by those organs and entities. In other States, those disputes are dealt with by means of the general mechanisms and procedures for review of administrative acts. Certain important aspects of proceedings for review, such as the forum where review may be sought and the remedies that may be granted, are related to fundamental conceptual and structural aspects of the legal system and the system of State administration in every country. Many legal systems provide for review of acts of administrative organs and other public entities before an administrative body that exercises hierarchical authority or control over the organ or entity. In legal systems that provide for such hierarchical administrative review, the question of which body or bodies are to exercise that function in respect of acts of particular organs or entities depends largely on the structure of the State administration. In the context of general procurement laws, for example, some States provide for review by a body that exercises overall supervision and control over procurement in the State (such as a central procurement board); in other States the review function is performed by the body that exercises financial control and oversight over operations of the Government and of the public administration. In some States, the review function in relation to particular types of cases involving administrative organs or other public entities is performed by specialized independent administrative bodies whose competence is sometimes referred to as "quasi-judicial". Those bodies are not, however, considered in those States to be courts within the judicial system.

122. Many national legal systems provide for judicial review of acts of administrative organs and public entities. In several of those legal systems judicial review is provided in addition to administrative review, while in other systems only judicial review is provided. Some legal systems provide only administrative review, and not judicial review. In some legal systems where both administrative and judicial review is provided, judicial review may be sought only after opportunities for administrative review have been exhausted; in other systems the two means of review are available as options. The main issue raised concerning judicial review is the effect that a judgement that annuls a

public bidding would have on the awarded contract, especially when public works have already been initiated. Procurement laws tend to attempt to strike a balance between the conflicting interests of the public sector, that is, the need to uphold the integrity of the procurement procedure and not to delay the rendering of a public service, and the interest of the bidders to preserve their rights. Except where a project agreement was the result of unlawful acts, a good solution is that a judgement should not render the project agreement void, but award damages to the injured party. It is usually agreed that such damages should not include loss of profits, but be limited to the cost incurred by the bidder in preparing the bid.

G. NOTICE OF PROJECT AWARD

123. Project agreements frequently include provisions that are of direct interest for parties other than the contracting authority and the concessionaire and who might have a legitimate interest in being informed about certain essential elements of the project. This is the case in particular 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 which may be of public interest. Such a requirement should apply regardless of the method used by the contracting authority to select the concessionaire (for example, whether through competitive selection procedures, direct negotiations or as a result of an unsolicited proposal). One possible procedure may be to require the contracting authority to publish a notice of the award of the project, indicating the essential elements of the proposed agreements, such as: *(a)* the name of the concessionaire; *(b)* a description of the works and services to be performed by the concessionaire; *(c)* the duration of the concession; *(d)* the price structure; *(e)* a summary of the essential rights and obligations of the concessionaire and the guarantees to be provided by it; *(f)* a summary of the monitoring rights of the contracting authority and remedies for breach of the project agreement; *(g)* a summary of the essential obligations of the Government, including any payment, subsidy or compensation offered by it; and *(h)* any other essential term of the project agreement, as provided in the request for proposals.

H. RECORD OF SELECTION AND AWARD PROCEEDINGS

124. In order to ensure transparency and accountability and to facilitate the exercise of the right of aggrieved bidders to seek review of decisions made by the contracting authority, the contracting authority should be required to keep an appropriate record of key information pertaining to the selection proceedings.

125. The record to be kept by the contracting authority should contain, as appropriate, such general information concerning the selection proceedings as is usually required to be recorded for public procurement (such as the information listed in article 11 of the UNCITRAL Model Procurement Law), as well as information of particular relevance for privately financed infrastructure projects. Such information may include the following:

(a) A description of the project for which the contracting authority requested proposals;

(b) The names and addresses of the companies participating in bidding consortia and the name and address of the members of the bidders with whom the project agreement has been entered into; and a description of the publicity requirements, including copies of the publicity used or of the invitations sent;

(c) If changes to the composition of the pre-selected bidders are subsequently permitted, a statement of the reasons for authorizing such changes and a finding as to the qualifications of any substitute or additional consortia concerned;

(d) Information relative to the qualifications, or lack thereof, of bidders; and a summary of the evaluation and comparison of proposals, including the application of any margin of preference;

(e) A summary of the conclusions of the preliminary feasibility studies commissioned by the contracting authority and a summary of the conclusions of the feasibility studies submitted by the qualified bidders;

(f) A summary of any requests for clarification of the pre-selection documents or the request for proposals, the responses thereto, as well as a summary of any modification of those documents;

(g) A summary of the principal terms of the proposals and of the project agreement;

(h) If the contracting authority has found most advantageous a proposal other than the proposal offering the lowest unit price for the expected output, a justification of the reasons for that finding by the awarding committee;

(i) If all proposals were rejected, a statement to that effect and the grounds for rejection;

(j) 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.

126. For selection proceedings that involve direct negotiations (see para. 89), it may be useful to include in the record of those proceedings, in addition to requirements referred to in paragraph 125 that may be applicable, the following additional information:

(a) A statement of the grounds and circumstances on which the contracting authority relied to justify the direct negotiation;

(b) The type of publicity used or the name and address of the company or companies directly invited to the negotiations;

(c) The name and address of the company or companies that requested to participate and those which were excluded from participating, if any, and the grounds for their exclusion;

(d) If the negotiations did not result in a project agreement, a statement to that effect and of the grounds therefor;

(e) The justification given for the selection of the final concessionaire.

127. For selection proceedings engaged in as a result of unsolicited proposals (see paras. 107-117), it may be useful to include in the record of those proceedings, in addition to requirements referred to in paragraph 125 that may be applicable, the following additional information:

(a) The name and address of the company or companies submitting the unsolicited proposal and a brief description of it;

(b) A certification by the contracting authority that the unsolicited proposal was found to be of public interest and to involve new concepts or technologies, as appropriate;

(c) The type of publicity used or the name and address of the company or companies directly invited to the negotiations;

(d) The name and address of the company or companies that requested to participate and those which were excluded from participating, if any, and the grounds for their exclusion;

(e) If the negotiations did not result in a project agreement, a statement to that effect and of the grounds therefor;

(f) The justification given for the selection of the final concessionaire.

128. It is advisable for the rules on record requirements to specify the extent and the recipients of the disclosure. Setting the parameters of disclosure involves balancing factors such as the general desirability, from the standpoint of the accountability of contracting authorities, of broad disclosure; the need to provide bidders with information necessary to enable them to assess their performance in the proceedings and to detect instances in which there are legitimate grounds for seeking review; and the need to protect the bidders' confidential trade information. In view of these considerations, it may be advisable to provide two levels of disclosure, as envisaged in article 11 of the UNCITRAL Model Procurement Law. The information to be provided to any member of the general public may be limited to basic information geared to the accountability of the contracting authority to the general public. However, it is advisable to provide for the disclosure for the benefit of bidders of more detailed information concerning the conduct of the selection, since that information is necessary to enable the bidders to monitor their relative performance in the selection proceedings and to monitor the conduct of the contracting authority in implementing the requirements of the applicable laws and regulations.

129. Moreover, appropriate measures should be taken to avoid the disclosure of confidential trade information of suppliers and contractors. That is true in particular with respect to what is disclosed concerning the evaluation and comparison of proposals, as excessive disclosure of such information may be prejudicial to the legitimate commercial interests of bidders. As a general rule, the contracting authority should not disclose more detailed information relating to the examination, evaluation and comparison of proposals and proposal prices, except when ordered to do so by a competent court.

130. Provisions on limited disclosure of information relating to the selection process would not preclude the applicability to certain parts of the record of other statutes in the enacting State that confer on the public at large a general right to obtain access to government records. Disclosure of the information in the record to legislative or parliamentary oversight bodies may be mandated pursuant to the law applicable in the host country.

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Chapter IV. Construction and operation of infrastructure

CONTENTS

LEGISLATIVE RECOMMENDATIONS

For host countries wishing to promote privately financed infrastructure projects it is recommended that the following principles be implemented by the law:

General provisions on the project agreement (see paras. 1-11)

Recommendation 39. The law might identify the core terms to be provided in the project agreement, which may include those terms referred to in recommendations _____ below.

Recommendation 40. Unless otherwise provided, the project agreement is governed by the law of the host country.

Organization of the concessionaire (see paras. 12-18)

Recommendation 41. The contracting authority should have the option to require that the selected bidders establish an independent legal entity with a seat in the country.

Recommendation 42. The project agreement should specify the minimum capital of the project company and the procedures for obtaining the approval of the contracting authority to its statutes and by-laws of the project company and fundamental changes therein.

The project site, assets and easements (see paras. 19-32)

Recommendation 43. The project agreement should specify, as appropriate, which assets will be public property and which assets will be the private property of the con-

cessionaire. The project agreement should further identify which assets the concessionaire is required to transfer to the contracting authority or to a new concessionaire upon expiry or termination of the project agreement; which assets the contracting authority, at its option, may purchase from the concessionaire; and which assets the concessionaire may freely remove or dispose of upon expiry or termination of the project agreement.

Recommendation 44. The contracting authority should assist the concessionaire in the acquisition of easements needed for the operation, construction and maintenance of the facility. The law might empower the concessionaire to enter upon, transit through, do work or fix installations upon property of third parties, as required for the construction and operation of the facility.

Financial arrangements (see paras. 33-51)

Recommendation 45. The law should enable the concessionaire to collect tariffs or user fees for the use of the facility or the services it provides. The project agreement should provide for methods and formulas for the adjustment of those tariffs or user fees.

Recommendation 46. Where the tariffs or fees charged by the concessionaire are subject to external control by a regulatory agency, the law should set forth the mechanisms for periodic and extraordinary revisions of the tariff adjustment formulas.

Recommendation 47. The contracting authority should have the power, where appropriate, to agree to make direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users or to enter into commitments for the purchase of fixed quantities of goods or services.

Security interests (see paras. 52-61)

Recommendation 48. The concessionaire should be responsible for raising the funds required to construct and operate the infrastructure facility and, for that purpose, should have the right to secure any financing required for the project with a security interest in any of its property, with a pledge of shares of the project company, with a pledge of the proceeds and receivables arising out of the concession or with other suitable security, without prejudice to any rule of law that might prohibit the creation of security interests in public property in the possession of the concessionaire.

Assignment of the concession (see paras. 62 and 63)

Recommendation 49. The project agreement should set forth the conditions under which the contracting authority might give its consent to an assignment of the concession, including the acceptance by the new concessionaire of all obligations under the project agreement and evidence of the new concessionaire's technical and financial capability as necessary for providing the service. The concession should not be assigned to third parties without the consent of the contracting authority.

Transfer of controlling interest in the project company (see paras. 64-68)

Recommendation 50. The transfer of a controlling interest in the capital of a concessionaire company may require the consent of the contracting authority.

Construction works (see paras. 69-79)

Recommendation 51. The project agreement should set forth the procedures for the review and approval of construction plans and specifications by the contracting authority, the contracting authority's right to monitor the construction of, or improvements to, the infrastructure facility, the conditions under which the contracting authority may order variations in respect of construction specifications and the procedures for testing and final inspection, approval and acceptance of the facility, its equipment and appurtenances.

Operation of infrastructure (see paras. 80-97)

Recommendation 52. The project agreement should set forth, as appropriate, the extent of the concessionaire's obligations to ensure:

(a) The adaptation of the service so as to meet the actual demand for the service;

(b) The continuity of the service;

(c) The availability of the service under essentially the same conditions to all users;

(d) The non-discriminatory access, as appropriate, of other service providers to any public infrastructure network operated by the concessionaire.

Recommendation 53. The project agreement should set forth:

(a) The extent of the concessionaire's obligation to provide the contracting authority or a regulatory agency, as appropriate, with reports and other information on its operations;

(b) The procedures for monitoring the concessionaire's performance and for the taking of such reasonable actions as the contracting authority or a regulatory agency may find appropriate, to ensure that the infrastructure facility is properly operated and the services are provided in accordance with the applicable legal and contractual requirements.

Recommendation 54. The concessionaire should have the right to issue and enforce rules governing the use of the facility, subject to the approval of the contracting authority or a regulatory agency.

General contractual arrangements (see paras. 98-150)

Recommendation 55. The contracting authority may reserve the right to review and approve major contracts to be entered into by the concessionaire, in particular contracts with the concessionaire's own shareholders or related persons. The contracting authority's approval should not normally be withheld except where the contracts contain provisions inconsistent with the project agreement or manifestly contrary to the public interest or to mandatory rules of a public law nature.

Recommendation 56. The concessionaire and its lenders, insurers and other contracting partners should be free to choose the law applicable to govern their contractual relations, except where such a choice would violate the host country's public policy.

Recommendation 57. The project agreement should set forth:

(a) The forms, duration and amounts of the guarantees of performance that the concessionaire may be required to provide in connection with the construction and the operation of the facilities;

(b) The insurance policies that the concessionaire may be required to maintain;

(c) The compensation to which the concessionaire may be entitled following the occurrence of legislative changes or other changes in the economic or financial conditions that render the performance of the obligation substantially more onerous than originally foreseen. The project agreement should further provide mechanisms for revising the terms of the project agreement following the occurrence of any such changes;

(d) The extent to which either party may be exempt from liability for failure or delay in complying with any obligation under the project agreement owing to circumstances beyond their reasonable control;

(e) Remedies available to the contracting authority and the concessionaire in the event of default by the other party.

Recommendation 58. The project agreement should set forth the circumstances under which the contracting authority may temporarily take over the operation of the facility for the purpose of ensuring the effective and uninterrupted delivery of the service in the event of serious failure by the concessionaire to perform its obligations.

Recommendation 59. The contracting authority should be authorized to enter into agreements with the lenders providing for the appointment, with the consent of the contracting authority, of a new concessionaire to perform under the existing project agreement if the concessionaire seriously fails to deliver the service required or if other specified events occur that could justify the termination of the project agreement.

NOTES ON THE LEGISLATIVE RECOMMENDATIONS

A. GENERAL PROVISIONS OF THE PROJECT AGREEMENT

1. The "project agreement" between the contracting authority and the concessionaire is the central contractual document in an infrastructure project. The project agreement defines the scope and purpose of the project as well as the rights and obligations of the parties; it provides details on the execution of the project and sets forth the conditions for the operation of the infrastructure or the delivery of the relevant services. Project agreements may be contained in a single document or may consist of more than one separate agreement between the contracting authority and the concessionaire. This section discusses the relation between the project agreement and the host country's legislation on privately financed infrastructure projects. It also discusses procedures and formalities for the conclusion and entry into force of the project agreement.

1. Legislative approaches

2. Domestic legislation often contains provisions dealing with the content of the project agreement. In some countries, the law merely refers to the need for an agreement between the concessionaire and the contracting authority, 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 laws which list a number of issues that need to be addressed in the project agreement without regulating in detail the content of its clauses.

3. General legislative provisions on certain essential elements of the project agreement may serve the purpose of establishing a general framework for the allocation of rights and obligations between the parties. They may be intended to ensure consistency in the treatment of certain contractual issues and to provide guidance to the public authorities involved in the negotiation of project agreements at different levels of government (national, provincial or local). Such guidance may be found particularly useful by contracting authorities lacking experience in the negotiation of project agreements. Lastly, legislation may sometimes be required so as to provide the contracting authority with the power to agree on certain types of provisions.

4. However, general legislative provisions dealing in detail with the rights and obligations of the parties might deprive the contracting authority and the concessionaire of the necessary flexibility to negotiate an agreement that takes into account the needs and particularities of a specific project. Therefore, it is advisable to limit the scope of general 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 which might affect the interests of third parties or provisions relating to essential policy matters on which variation by agreement is not admitted.

2. The law governing the project agreement

5. Statutory provisions on the law applicable to the project agreement are not frequently found in domestic legislation on privately financed infrastructure projects. Where they do appear, they usually provide for the application of the laws of the host country by a general reference to domestic law or by mentioning special statutory or regulatory texts that apply to the project agreement. In some legal systems there may be an implied submission to the laws of the host country, even in the absence of a statutory provision to that effect.

6. The law governing the project agreement includes the rules contained in laws and regulations of the host country related directly to privately financed infrastructure projects, where specific legislation on the matter exists. The main elements of those laws have been considered in previous

chapters of the *Guide*. In some countries the project agreement may be subject to administrative law, while in others the project agreement may be governed by private law (see chap. VII, "Other relevant areas of law", ___). The governing law also includes legal rules of other fields of law that apply to the various issues that arise during the execution of an infrastructure project (see chap. VII, "Other relevant areas of law", ___). Some of those rules may be of an administrative or other public law nature and their application in the host country may be mandatory, such as those dealing with environmental protection measures and health and labour conditions. Some domestic laws expressly identify the matters that are subject to rules of mandatory application. However, a number of issues arising out of the project agreement or the operation of the facility may not be the subject of mandatory rules of a public law nature. This is typically the case of most contractual issues arising under the project agreement (for example, formation, validity and breach of contract, including liability and compensation for breach of contract and wrongful termination).

7. Host countries wishing to adopt legislation on privately financed infrastructure projects where no such legislation exists may need to address the various issues raised by such projects in more than one statutory instrument. Other countries may wish to introduce legislation dealing only with certain issues that have not already been addressed in a satisfactory manner in existing laws and regulations. For instance, specific legislation on privately financed infrastructure projects could establish the particular features of the procedures to select the concessionaire and refer, as appropriate, to existing legislation on the award of government contracts for details on the administration of the process. By the same token, when adopting legislation on privately financed infrastructure projects, host countries may need to repeal the application of certain laws and regulations that, in the view of the legislature, constitute obstacles to their implementation.

8. For purposes of clarity, it may be useful to provide information to potential investors concerning those statutory and regulatory texts which are directly applicable to the execution of privately financed infrastructure projects and, as appropriate, those whose application has been repealed by the legislature. However, as it would not be possible to list exhaustively in the law all the statutes or regulations of direct or subsidiary relevance for privately financed infrastructure projects, such a list might best be provided in a non-legislative document, such as a promotional brochure or general information provided to bidders with the request for proposals (see chap. III, "Selection of the concessionaire", para. 60).

3. Conclusion of the project agreement

9. For projects as complex as infrastructure projects, it is not unusual for several months to elapse in the final negotiations (see chap. III, "Selection of the concessionaire", paras. 83 and 84) before the parties are ready to sign the project agreement. Additional time may also be needed in order to accomplish certain formalities that are often prescribed by law, such as approval of the project agreement by a higher authority. The entry into force of the project agreement or of certain categories of project agreement is in some countries subject to an act of parliament or even the adoption of special legislation. Given the cost entailed by delay in the implementation of the project agreement, it is advisable to find ways of expediting the final negotiations in order to avoid unnecessary delay in the conclusion of the project agreement.

10. A number of factors have been found to cause delay in negotiations, such as inexperience of the parties, poor coordination between different public authorities, uncertainty as to the extent of governmental support and difficulties in establishing security arrangements acceptable to the lenders. The Government may make a significant contribution by providing adequate guidance to negotiators acting on behalf of the contracting authority in the country. The clearer the understanding of the parties as to the provisions to be made 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 may be considerable risk of costly and protracted negotiations as well as of justified complaints that the selection process was not sufficiently transparent and competitive (see also chap. III, "Selection of the concessionaire", paras. 83 and 84).

11. The procedures for conclusion and entry into force of the project agreement should also be reviewed with a view to expediting matters and avoiding the adverse consequences of delays in the project's timetable. In some countries the power to bind the contracting authority or the Government, as appropriate, 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 would not be feasible or where final approvals by another entity may still be required, it would be desirable to consider streamlining the approval procedures. Where such procedures are perceived as arbitrary or cumbersome, the Government may be requested to provide sufficient guarantees to the concessionaire and the lenders against such risk (see chap. II, "Project risks and government support", paras. 45-50). In some countries where approval requirements exist, contracting authorities have sometimes been authorized to compensate the selected bidder for costs incurred during the selection process and in preparations for the project, should final approval be withheld for reasons not attributable to the selected bidder.

B. ORGANIZATION OF THE CONCESSIONAIRE

12. Certain requirements concerning the organization of the concessionaire are often found in domestic legislation and are elaborated upon by detailed provisions in project agreements. They typically deal with issues such as the establishment of the concessionaire as a legal entity, its capital, scope of activities, statutes and by-laws. In most cases, the selected bidders establish a project company as an independent legal entity with its own juridical personality, which then becomes the concessionaire under the

project agreement. A project company established as an independent legal entity is the vehicle typically used for raising financing under the project finance modality (see "Introduction and background information on privately financed infrastructure projects", para. 54). Its establishment facilitates coordination in the execution of the project and provides a mechanism for protecting the interests of the project, which may not necessarily coincide with the individual interests of all of the project promoters. 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.

13. The project company is usually required to be established within a reasonably short period after the award of the project. Since a substantial part of the liabilities and obligations of the concessionaire, including long-term ones (project agreement, loan and security agreements and 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. However, firm and final commitments by the lenders and other capital providers cannot reasonably be expected to be available prior to the final award of the concession.

14. Entities providing public services are often required to be established as legal entities under the laws of the host country. This requirement reflects the legislature's interest to ensure, inter alia, that public service providers comply with domestic accounting and publicity provisions (such as publication of financial statements or requirements to make public certain corporate acts). However, this emphasizes the need for the host country to have adequate company laws in place (see chap. VII, "Other relevant areas of law", ___). 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.

15. Another important issue concerns the equity investment required for the establishment of the project company. The contracting authority 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. However, as the total investment needed as well as the ideal proportion of debt and equity capital vary from project to project, 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. The contracting authority might instead be given more flexibility to arrive at a desirable amount of equity investment commensurate with the project's financial needs. For instance, the expected equity investment might be expressed as a desirable ratio between debt and equity in the request for proposals and might be included among the evaluation criteria for financial and commercial proposals, so as to stimulate competition among the bidders (see chap. III, "Selection of the concessionaire", paras. 75 and 76).

16. In any event, it is advisable to review legislative provisions or regulatory requirements relating to the organization of the concessionaire so as to ensure their consistency with international obligations assumed by the host country. Provisions that restrict or require specific types of legal entity or joint venture through which a service supplier may supply a service and limitations on the participation of foreign capital in terms of a maximum percentage limit on foreign share-holding or the total value of individual or aggregate foreign investment may be inconsistent with specific obligations undertaken by the signatory States of certain international agreements on economic integration or the liberalization of trade in services.

17. Domestic laws sometimes 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 may 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.

18. The contracting authority might also wish to be assured that the statutes and by-laws of the project company will adequately reflect the obligations assumed by the company in the project agreement. For this reason, project agreements sometimes provide that the entry into force of changes in the statutes and by-laws of the project company is effective upon approval by the contracting authority. Where the contracting authority or another public authority participates in the project company, provisions are sometimes made to the effect that certain decisions necessitate the positive vote of the contracting authority in the meeting of the shareholders or board. In any event, it is important to weigh the public interests represented through the contracting authority against the need to afford the project company the flexibility necessary for the conduct of its business. Where it is deemed necessary to require the contracting authority's approval to proposed amendments to the statutes and by-laws of the project company, it is advisable to limit such a requirement to cases concerning provisions deemed to be of fundamental importance (for example, amount of capital, classes of shares and their privileges or liquidation procedures), which should be identified in the project agreement.

C. THE PROJECT SITE, ASSETS AND EASEMENTS

19. Provisions relating to the site of the project are an essential part of most project agreements. They typically deal with issues such as the acquisition of the required land, title to land and project assets, and easements required by the concessionaire to carry out works or to operate the infrastructure. To the extent that the project agreement contemplates transfer of public property to the concessionaire or the creation of a right of use regarding public property, prior legislative authority may be required. Legislation may also be needed to facilitate the acquisition of the required property or easements when the project site is not located on public property.

1. Acquisition of land required for execution of the project

20. Where a new infrastructure facility is to be built on public land (that is, land owned by the contracting authority or another public authority) or an existing infrastructure facility is to be modernized or rehabilitated, it will normally be for the owner of such land or facility to make it available to the concessionaire. The situation is more complex when the land is not already owned by the contracting authority and needs to be purchased from its owners. In most cases, the concessionaire would not be in the best position to assume responsibility for purchasing the land needed for the project, in view of the potential delay and expense involved in negotiations with a possibly large number of individual owners and, as may be necessary in some jurisdictions, 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. It is therefore typical for the contracting authority to assume responsibility for providing the land required for the implementation of the project, so as to avoid unnecessary delay or increase in project cost as a result of the acquisition of land. The contracting authority may purchase the required land from its owners or, if necessary, acquire it compulsorily.

21. The procedure whereby private property is compulsorily acquired by the Government against the payment of appropriate compensation to the owners, which is referred to in domestic legal systems by various technical expressions, such as "expropriation", is referred to in the present *Guide* as "compulsory acquisition". In countries where the law contemplates more than one type of procedure for compulsory acquisition, it may be desirable to authorize the competent public authorities to carry out all acquisitions required for privately financed infrastructure projects pursuant to the most efficient of those procedures, such as the special procedures that in some countries apply for reasons of compelling public need (see chap. VII, "Other relevant areas of law", ___).

22. The power to acquire property compulsorily is usually vested in the Government, but the laws of a number of countries also authorize infrastructure operators or public service providers (such as railway companies, electricity authorities or telephone companies) to perform certain actions for the compulsory acquisition of private property required for providing or expanding their services to the public. In those countries in particular where the award of compensation to the owners of the property compulsorily acquired 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 compulsory acquisition, while the Government remains responsible for accomplishing those acts which, under the relevant legislation, are preconditions to the initiation of the acquisition proceedings. Upon acquisition, the land often becomes public property, although in some cases the law may authorize the contracting authority and the concessionaire to agree on a different arrangement, taking into account their respective shares in the cost of acquiring the property.

2. Ownership of project assets

23. As indicated earlier, 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 (see "Introduction and background information on privately financed infrastructure projects", paras. 47-53). Irrespective of the host country's general or sectoral policy, it is important that the ownership regime of the various assets involved be clearly defined and based on sufficient legislative authority. However, there may be no compelling need for detailed legislative provisions on this matter. In various countries it was found sufficient to provide legislative guidance as to matters that need to be addressed in the project agreement.

24. In some legal systems, physical infrastructure required for the provision of public services is generally regarded as public property, even where it was originally acquired or created with private funds. This would typically include any property especially acquired for the construction of the facility in addition to any property that might have been made available to the concessionaire by the contracting authority. However, during the life of the project the concessionaire may make extensive improvements or additions to the facility. It may not always be easily ascertainable under the applicable law whether or not such improvements or additions become an integral part of the public assets held in possession by the concessionaire or whether some of them may be separable from the public property held by the concessionaire and become the concessionaire's private property. It is therefore advisable for the project agreement to specify, as appropriate, which assets will be public property and which will become the private property of the concessionaire.

25. The need for clarity in respect of ownership of project assets is not limited to legal systems where physical infrastructure required for the provision of public services is regarded as public property. Generally, where the contracting authority provides the land or facility required to execute the project, it is advisable for the project agreement to specify, as appropriate, which assets will remain public property and which will become the private property of the concessionaire. The concessionaire may either receive title to such land or facilities or be granted only a leasehold interest or the right to use the land or facilities and build upon it, in particular where the land remains public property. In either case, the nature of the concessionaire's rights should be clearly established, as this will directly affect the concessionaire's ability to create security interests in project assets for the purpose of raising financing for the project (see paras. 54 and 55).

26. In addition to the ownership of assets during the duration of the concession period, it is important to consider the ownership regime upon expiry or termination of the project agreement. In some countries the law places particular emphasis on the contracting authority's interest in the physical assets related to the project and generally require the handover to the contracting authority of all of them, whereas in other countries privately financed infrastructure projects are regarded primarily as a means of pro-

curing services over a specified period, rather than of constructing assets. Thus, the laws of the latter countries limit the concessionaire's handover obligations to public assets and property originally made available to the concessionaire or certain other assets deemed to be necessary to ensure provision of the service. Sometimes, such property is transferred directly from the concessionaire to another concessionaire who succeeds it in the provision of the service.

27. Differences in legislative approaches often reflect the varying role of the public and private sectors under different legal and economic systems, but may also be the result of practical considerations on the part of the contracting authority. One practical reason for the contracting authority to allow the concessionaire to retain certain assets at the end of the project period may be the desire to lower the cost at which the service will be provided. If the project assets are likely to have a residual value for the concessionaire and that value can be taken into account during the selection process, the contracting authority may expect the tariffs charged for the service to be lower. Indeed, if the concessionaire does not expect to have to cover the entire cost of the assets in the life of the project, but can cover part of it by selling them, or using them for other purposes, after the project agreement expires, there is a possibility that the service may be provided at a lower cost than if the concessionaire had to cover all its costs in the life of the project. Moreover, certain assets may require such extensive refurbishing or technological upgrading at the end of the project period that it might not be cost-effective for the contracting authority to claim them. There may also be residual liabilities or consequential costs, for instance, because of liability for environmental damage or demolition costs.

28. For these reasons, the laws of some countries do not contemplate an unqualified transfer of all assets to the contracting authority, but allow a distinction between three main categories of assets:

(a) Assets that must be transferred to the contracting authority. This category typically includes public property that was used by the concessionaire to provide the service concerned. Assets may include both facilities made available to the concessionaire by the contracting authority and new facilities built by the concessionaire pursuant to the project agreement. Some laws also require the transfer of assets, goods and property subsequently acquired by the concessionaire for the purpose of operating the facility, in particular where they become part of, or are permanently affixed to, the infrastructure facility to be handed over to the contracting authority;

(b) Assets that may be purchased by the contracting authority, at its option. This category usually includes assets originally owned by the concessionaire, or subsequently acquired by it, which, without being indispensable or strictly necessary for the provision of the service, may enhance the convenience or efficiency of operating the facility or the quality of the service;

(c) Assets that remain the private property of the concessionaire. These are assets owned by the concessionaire that do not fall under *(b)* above. Typically the contracting authority is not entitled to such assets, which may be freely removed or disposed of by the concessionaire.

29. In the light of the above, it is useful to require in the law that the project agreement specify, as appropriate, which assets will be public property and which assets will be the private property of the concessionaire. The project agreement should identify which assets the concessionaire is required to transfer to the contracting authority or to a new concessionaire upon expiry or termination of the project agreement; which assets the contracting authority, at its option, may purchase from the concessionaire and which assets the concessionaire may freely remove or dispose of upon expiry or termination of the project agreement. These provisions should be complemented by contractual criteria for establishing, as appropriate, the compensation to which the concessionaire may be entitled in respect of assets transferred to the contracting authority or to a new concessionaire or purchased by the contracting authority upon expiry or termination of the project agreement (see chap. V, "Duration, extension and termination of the project agreement", ___).

3. Easements

30. Special arrangements may be required, in cases where the concessionaire needs to transit on or through the property of third parties to access the project site or to perform or maintain any works required for the provision of the service (for example, to place traffic signs on adjacent lands; to install poles or electric transmission lines above third parties' property; to install and maintain transforming and switching equipment; to trim trees that interfere with telephonic lines placed on abutting property; or to lay oil, gas or water pipes).

31. The right to use another person's property for a specific purpose or to do work on it is often referred to by the word "easement". Easements usually require the consent of the owner of the property to which they pertain, unless such rights are provided by the law. Usually it is not an expeditious or cost-effective solution to leave it to the concessionaire to acquire easements directly from the owners of the properties concerned. Instead it is more frequent that those easements are compulsorily acquired by the contracting authority simultaneously with the project site.

32. A somewhat different alternative might be for the law itself to empower public service providers to enter, pass through or do work or fix installations upon the property of third parties, as required for the construction, operation and maintenance of public infrastructure. Such an approach, which may obviate the need to acquire easements in respect of individual properties, may be used in sector-specific legislation where it is deemed possible to determine, in advance, certain minimum easements that may be needed by the concessionaire. 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 structures and transforming and switching equipment; maintaining, repairing and

removing any of those installations; establishing a safety zone along underground or overhead cables; or removing obstacles along the wires or encroaching on the safety zone. Under some legal systems, the owners may be entitled to compensation should the extent of the rights granted to the concessionaire be such that the use of the properties by their owners is substantially hindered.

D. FINANCIAL ARRANGEMENTS

33. Financial arrangements typically include provisions concerning the concessionaire's obligations to raise funds for the project, outline the mechanisms for disbursing and accounting for funds, establish methods for calculating and adjusting the tariffs charged by the concessionaire and deal with the types of security interests that may be established in favour of the concessionaire's creditors. It is important to ensure that the laws of the host country facilitate or at least do not pose obstacles to the financial management of the project.

1. Financial obligations of the concessionaire

34. In privately financed infrastructure projects the concessionaire is typically responsible for raising the funds required to construct and operate the infrastructure facility. The concessionaire's obligations in this regard are typically set forth in detailed provisions in the project agreement. In most cases, the contracting authority or other public authorities would be interested in limiting their financial obligations to those specifically expressed in the project agreement or those forms of direct support that the Government has agreed to extend to the project.

35. The amount of private capital contributed directly by the project company's shareholders typically represents only a portion of the total proposed investment. A far greater portion derives from loans extended to the concessionaire by commercial banks and international financial institutions and from the proceeds of the placement of bonds and other negotiable instruments on the capital market (see "Introduction and background information on privately financed infrastructure projects", paras. 54-67). It is therefore important to ensure that the law does not unnecessarily restrict the concessionaire's ability to enter into the financial arrangements it sees fit for the purpose of financing the infrastructure.

2. Tariff setting and tariff control

36. Tariffs or usage fees charged by the concessionaire may be the main (sometimes even the sole) source of revenue to recover the investment made in the project in the absence of subsidies or payments by the contracting authority (see paras. 47-51) or the Government (see chap. II, "Project risks and government support," paras. 30-60). The concessionaire will therefore seek to be able to set and maintain tariffs and fees at a level that ensures sufficient cash flow for the project. However, in some legal systems there may be limits to the concessionaire's freedom to establish tariffs and fees. The cost at which public services are provided is typically an element of the Governments's infrastructure policy and a matter of immediate concern for large sections of the public. Thus, the regulatory framework in many countries includes special rules to control tariffs and fees for the provision of public services. Furthermore, statutory provisions or general rules of law in some legal systems establish parameters for pricing goods or services, for instance by requiring that tariffs meet certain standards of "reasonableness", "fairness" or "equity".

(a) The concessionaire's authority to collect tariffs

37. In a number of countries prior legislative authorization may be necessary in order for a concessionaire to collect tariffs for the provision of public services or to demand a fee for the use of public infrastructure facilities. The absence of such a general provision in legislation has in some countries given rise to judicial disputes challenging the concessionaire's authority to charge a tariff for the service.

38. Where it is deemed necessary to include in general legislation provisions concerning the level of tariffs and user fees, they should seek to achieve a balance between the interests of investors and current and future users. It is advisable that statutory criteria for determining tariffs and fees take into account, in addition to social factors the Government regards as relevant, the concessionaire's interest in achieving a level of cash flow that ensures the economic viability and commercial profitability of the project. Furthermore, it is advisable to provide the parties with the necessary authority to negotiate appropriate arrangements, including compensation provisions, in order to address situations where the application of tariff control rules directly or indirectly related to the provision of public services may result in fixing tariffs or fees below the level required for the profitable operation of the project (see para. 124).

(b) Tariff control methods

39. Domestic laws often subject tariffs or user fees to some control mechanism. Many countries have chosen to set only the broad tariff principles in legislation while leaving their actual implementation to the regulatory agency concerned and to the terms and conditions of licences or concessions. This approach is advisable because formulas are sector-specific and may require adaptation during the life of a project. Where tariff control measures are used, the law typically requires that the tariff formula be advertised with the request for proposals and be incorporated into the project agreement. Tariff control systems typically consist of formulas for the adjustment of tariffs and monitoring provisions to ensure compliance with the parameters for tariff adjustment. The most common tariff control methods used in domestic laws are based on rate-of-return and price-cap principles. There are also hybrid regimes that have elements of both. It should be noted that a well-functioning tariff control mechanism requires detailed commercial and economic analysis and that the brief discussion that follows offers only an overview of selected issues and possible solutions.

(i) Rate-of-return method

40. Under the rate-of-return method, the tariff adjustment mechanism is devised so as to allow the concessionaire an agreed rate of return on its investment. The tariffs for any given period are established on the basis of the concessionaire's overall revenue requirement to operate the facility, which involves determining its expenses, the investments undertaken to provide the services and the allowed rate of return. Reviews of the tariffs are undertaken periodically, sometimes whenever the contracting authority or other interested parties consider that the actual revenue is higher or lower than the revenue requirement of the facility. For that purpose, the contracting authority verifies the expenses of the facility, determines to what extent investments undertaken by the concessionaire are eligible for inclusion in the rate base and calculates the revenues that need to be generated to cover the allowable expenses and the return on investment agreed upon. The rate-of-return method is typically used in connection with the supply of public services for which a constant demand can be forecast, such as power, gas or water supply. For facilities or services exposed to greater elasticity of demand, such as tollroads, it might not be possible to keep the concessionaire's rate of return constant by regular tariff adjustments.

41. The rate-of-return method has been found to provide a high degree of security for infrastructure operators, since the concessionaire is assured that the tariffs charged will be sufficient to cover its operating expenses and allow the agreed rate of return. Because tariffs are adjusted regularly, thus keeping the concessionaire's rate of return essentially constant, investment in companies providing public services is exposed to little market risk. The result is typically lower costs of capital. The possible disadvantage of the rate-of-return method is that it provides little incentive for infrastructure operators to minimize their costs because of the assurance that those costs will be recovered through tariff adjustments. However, some level of incentive may exist if the tariffs are not adjusted instantaneously or if the adjustment does not apply retroactively. It should be noted that the implementation of the rate-of-return method requires a substantial amount of information, as well as extensive negotiations (for example, on eligible expenditures and cost allocation).

(ii) Price-cap method

42. Under the price-cap method, a tariff formula is set for a given period (such as four or five years) taking into account future inflation and future efficiency gains expected from the facility. Tariffs 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 groups of services only, and different formulas may be used for different groups. The periodic readjustment of the formula is, however, based on the rate-of-return type of calculations, requiring the same type of detailed information as indicated above, though on a less frequent basis.

43. The implementation of the price-cap method may be less complex than the rate-of-return method. The price-cap method has been found to provide greater incentives for public service providers, since the concessionaire retains the benefits of lower than expected costs until the next adjustment period. At the same time, however, public service providers are typically exposed to more risk under the price-cap method than under the rate-of-return method. In particular, the concessionaire faces the risk of loss when the costs turn out to be higher than expected, since the concessionaire cannot raise the tariffs until the next tariff adjustment. The greater risk exposure increases the costs of capital. If the project company's returns are not allowed to rise, there might be difficulties in attracting new investment. Also, the company might be tempted to lower the quality of the service in order to reduce costs.

(iii) Hybrid methods

44. Many tariff adjustment methods currently being used combine elements of both the rate-of-return and the price-cap methods with a view to both reducing the risk borne by the service providers and providing sufficient incentives for efficiency in the operation of the infrastructure. One such hybrid method employs sliding scales for adjusting the tariffs that ensure upward adjustment when the rate of return falls below a certain threshold and downward adjustment when the rate of return exceeds a certain maximum, with no adjustment for rates of return falling between those levels. Other possible approaches to balancing the rate-of-return and price-cap methods include a review by the contracting authority of the investments made by the concessionaire to ensure that they meet the criteria of usefulness in order to be taken into account when calculating the concessionaire's revenue requirement. Another tariff adjustment technique that may be used to set tariffs, or more generally to monitor tariff levels, is benchmark or yardstick pricing. By comparing the various cost components of one public service provider with those of another and with international norms, the contracting authority may be able to judge whether tariff adjustments requested by the public service provider are reasonable.

(c) Policy considerations on tariff control

45. Each of the main tariff adjustment methods discussed above has its own advantages and disadvantages and varying impact on private sector investment decisions (see paras. 41 and 43). This should be taken into account by the legislature when considering the appropriateness of tariff control methods to domestic circumstances. Different methods may also be used for different infrastructure sectors. Some laws indeed authorize the contracting authority to apply either a price-cap or rate-of-return method in the selection of concessionaires, according to the scope and nature of investments and services. In choosing a tariff control method, it is important to take into account the impact of the various policy options on private sector investment decisions . Whatever mechanism is chosen, the capacity of the contracting authority or the regulatory agency to monitor adequately the performance of the concessionaire and to implement the adjustment method satisfactorily should be carefully considered (see also chap. I, "General legislative and institutional framework", paras. 30-53).

46. It is important to bear in mind that tariff adjustment formulas cannot be set once and for all, as technology, exchange rates, wage levels, productivity and other factors are bound to change significantly, sometimes even unpredictably, over the concession period. Furthermore, tariff adjustment formulas are typically drawn up assuming a certain level of output or demand and may lead to unsatisfactory results if the volume of output or demand changes considerably. Therefore, many countries have established mechanisms for revision of tariff formulas, including periodic revisions (every four or five years, say) of the formula or ad hoc revisions whenever it is demonstrated that the formula has failed to ensure adequate compensation to the concessionaire (see also paras. 59-68). The tariff regime will also require adequate stability and predictability to enable public service providers and users to plan accordingly and to allow financing based on a predictable revenue. Investors and lenders may be particularly concerned about regulatory changes affecting the tariff adjustment method. Thus, they typically require the tariff adjustment formula to be incorporated into the project agreement.

3. Financial obligations of the contracting authority

47. Where the concessionaire offers services directly to the general public, the contracting authority or other public authority may undertake to make direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users. Where the concessionaire produces a commodity for further transmission or distribution by another service provider, the contracting authority may undertake to purchase that commodity wholesale at an agreed price and on agreed conditions. The main examples of such arrangements are discussed briefly below.

(a) Direct payments

48. Direct payments by the contracting authority have been used in some countries as a substitute for, or as a supplement to, payments by the end users, in particular in tollroad projects, through a mechanism known as "shadow tolling". Shadow tolls are arrangements whereby the concessionaire assumes the obligation to develop, build, finance and operate a road or another transportation facility for a set number of years in exchange for periodic payments in place of, or in addition to, real or explicit tolls paid by users. Shadow toll schemes may be used to address risks that are specific to transportation projects, in particular the risk of lower-than-expected traffic levels (see chap. II, "Project risks and government support", para. 18). Furthermore, shadow toll schemes may be politically more acceptable than direct tolls, for example, where it is feared that the introduction of toll payments on public roads may give rise to protests by road users. However, where such arrangements involve some form of subsidy to the project company, their conformity with certain obligations of the host country under international agreements on regional economic integration or trade liberalization should be carefully considered.

49. Shadow tolls may involve a substantial expenditure for the contracting authority and require close and extensive monitoring by the contracting authority. In countries that have used shadow tolls for the development of new road projects, payments by the contracting authority to the concessionaire are based primarily on actual traffic levels, as measured in vehicle-miles. It is considered advisable to provide that payments are not made until traffic begins, so that the concessionaire has an incentive to open the road as quickly as possible. At the same time, it has been found useful to calculate payments on the basis of actual traffic for the duration of the concession. This system gives the concessionaire a reason to ensure that usage of the road will be disrupted as little as possible by repair works. Alternatively, the project agreement could contain a penalty or liquidated damages clause for lack of lane availability resulting from repair works. The concessionaire is typically required to perform continuous traffic counts to calculate annual vehicle-miles, which are verified periodically by the contracting authority. A somewhat modified system may combine both shadow tolls and direct tolls paid by the users. In such a system, shadow tolls are only paid by the contracting authority in the event that the traffic level over a certain period falls below the agreed minimum level necessary for the concessionaire to operate the road profitably.

(b) Purchase commitments

50. In the case of independent power plants or other facilities that generate goods or services capable of being delivered on a long-term basis to an identified purchaser, the contracting authority or other public authority often assume an obligation to purchase such goods and services, at an agreed rate, as they are offered by the concessionaire. Contracts of this type are usually referred to as "off-take agreements". Off-take agreements often include two types of payments: payments for the availability of the production capacity and payments for units of actual consumption. In a power generation project, for example, the power purchase agreement may contemplate the following charges:

(a) Capacity charges. These are charges payable regardless of actual output in a billing period and are calculated to be sufficient to pay all of the concessionaire's fixed costs incurred to finance and maintain the project, including debt service and other ongoing financing expenses, fixed operation and maintenance expenses and a certain rate of return. The payment of capacity charges is often subject to the observance of certain performance or availability standards;

(b) Consumption charges. These charges are not intended to cover all of the concessionaire's fixed costs, but rather to pay the variable or marginal costs that the concessionaire has to bear to generate and deliver a given unit of the relevant service or good (such as a kilowatt-hour of electricity). Consumption charges are usually calculated to cover the concessionaire's variable operating costs, such as that of fuel consumed when the facility is operating, water treatment expenses and costs of consumables. Variable payments are often tied to the concessionaire's own variable operating costs or to an index that reasonably reflects changes in operating costs.

51. From the perspective of the concessionaire, a combined scheme of capacity and consumption charges is particularly useful to ensure cost recovery where the transmission or distribution function for the goods or services generated by the concessionaire is subject to a monopoly. However, the capacity charges provided in the off-take agreement should be commensurate with the other sources of generating capacity available to, or actually used by, the contracting authority. In order to ensure the availability of funds for payments by the contracting authority under the off-take agreement, it is advisable to consider whether advance budgeting arrangements are required. Payments under an off-take agreement may be backed by a guarantee issued by the host Government or by a national or international guarantee agency (see chap. II, "Project risks and government support", paras. 46 and 47).

E. SECURITY INTERESTS

52. Generally, security interests in personal property provide the secured creditor with essentially two kinds of rights: a property right allowing the secured creditor, in principle, to repossess the property or have a third party repossess and sell it, and a priority right to receive payment with the proceeds from the sale of the property in the event of default by the debtor. Security arrangements in project finance generally play a defensive or preventive role by ensuring that, in the event a third party acquires the debtor's operations (for example, by foreclosure, in bankruptcy or directly from the debtor) all of the proceeds resulting from the sale of those assets will go first to repayment of outstanding loans. Nevertheless, lenders would generally aim at obtaining security interests that allow them to foreclose and take possession of a project they can take over and operate either to restore its economical viability with a view to reselling at an appropriate time or to retaining the project indefinitely and collecting an ongoing revenue.

53. Security arrangements are crucial for financing infrastructure projects, in particular where the financing is structured under the "project finance" modality. The financing documents for privately financed infrastructure projects typically include both security over physical assets related to the project and security over intangible assets held by the concessionaire. A few of the main requirements for the successful closure of the security arrangements are discussed below. It should be noted, however, that, in some legal systems, any security given to lenders that makes it possible for them to take over the project is only allowed under exceptional circumstances and under certain specific conditions, namely, that the creation of such security requires the agreement of the contracting authority; that the security should be granted for the specific purpose of facilitating the financing or operation of the project; and that the security interests should not affect the obligations undertaken by the concessionaire. Those conditions often derive from general principles of law or from statutory provisions and cannot be waived by the contracting authority through contractual arrangements.

1. Security over physical assets

54. The negotiation of security arrangements required in order to obtain financing for the project may face legal obstacles where project assets are public property. If the concessionaire lacks title to the property it will in many legal systems have no (or only limited) power to encumber such property. Where limitations of this type exist, the law may still facilitate the negotiation of security arrangements for instance by indicating the types of asset in respect of which such security interests may be created or the type of security interest that is permissible. In some legal systems, a concessionaire that is granted a leasehold interest or right to use certain property may create a security interest over the leasehold interest or right to use.

55. Furthermore, security interests may also be created where the concession encompasses different types of public 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. Where it is possible to create any form of security interests in respect of assets owned by, or required to be handed over to, the contracting authority or assets in relation to which the contracting authority has a contractual option of purchase (see para. 28), the law may require the approval of the contracting authority in order for the concessionaire to create such security interests.

2. Security over intangible assets

56. The main intangible asset in an infrastructure project is the concession itself, that is, the concessionaire's right to operate the infrastructure or to provide the relevant service. In most legal systems, the concession provides its holder with the authority to control the entire project and entitles the concessionaire to earn the revenue generated by the project. Thus, the value of the concession well exceeds the combined value of all of the physical assets involved in a project. Because the concession holder would usually have the right to possess and dispose of all project assets (with the possible exception of those which are owned by other parties, such as public property in the possession of the concessionaire), the concession would typically encompass both present and future assets of a tangible or intangible nature. The lenders may therefore regard the concession as an essential component of the security arrangements negotiated with the concessionaire. A pledge of the concession itself may have various practical advantages for the concessionaire and the lenders, in particular in legal systems that would not otherwise allow the creation of security over all of a company's assets or which do not generally recognize non-possessory security interests (see chap. VII, "Other relevant areas of law", ___). These advantages may include avoiding the need to create separate security interests for each project asset, allowing the concessionaire to continue to deal with those assets in the ordinary course of business and making it possible to pledge certain assets without transferring actual possession of the assets to the creditors. Furthermore, a pledge of the concession may entitle the lenders, in case of default by the concessionaire, to avert termination of the project by taking over the concession and making arrangements for continuation of the project

under another concessionaire. A pledge of the concession may, therefore, represent a useful complement to or, under certain circumstances, a substitute for a direct agreement between the lenders and the contracting authority concerning the lenders' step-in rights (see paras. 147-150).

57. However, in some legal systems there may be obstacles to a pledge of the concession in the absence of express legislative authorization. Under various legal systems, security interests may only be created in respect of assets that can be freely transferable by the grantor of the security. Since the right to operate the infrastructure is in most cases not transferable without the consent of the contracting authority (see paras. 62 and 63), in some legal systems it may not be possible for the concessionaire to create security interests over the concession itself. Recent legislation in some civil law jurisdictions has removed that obstacle by creating a special category of security interest, sometimes referred to by expressions such as "*hipoteca de concesión de obra pública*" or "*prenda de concesión de obra pública*" ("public works concession mortgage" or "pledge of public works concession"), which generally provides the lenders with an enforceable security interest covering all of the rights granted to the concessionaire under the project agreement. However, in order to protect the public interest, the law requires the consent of the contracting authority for any measure by the lenders to enforce such a right, under conditions to be provided in an agreement between the contracting authority and the lenders. A somewhat more limited solution has been achieved in some common law jurisdictions in which a distinction has been made between the non-transferable right to carry out a certain activity under a governmental licence (that is, the "public rights" arising under the licence) and the right to claim proceeds received by the licensee (the latter's "private rights" under the licence).

3. Securities over trade receivables

58. Another form of security typically given in connection with most privately financed infrastructure projects is an assignment to lenders of proceeds from contracts with customers of the concessionaire. Those proceeds may consist of the proceeds of a single contract (such as a power purchase commitment by a power distribution entity) or of a large number of individual transactions (such as monthly payment of gas or water bills). Those proceeds typically include the tariffs charged to the public for the use of the infrastructure (for example, tolls on a tollroad) or the price paid by the customers for the goods or services provided by the concessionaire (electricity charges, for example). 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 and the loan agreements often require that the proceeds of infrastructure projects be deposited in an escrow account managed by a trustee appointed by the lenders. Such a mechanism may also play an essential role in the issuance of bonds and other negotiable instruments by the concessionaire.

59. Security over trade receivables plays a central role in financing arrangements that involve the placement of bonds and other negotiable instruments. Those instruments may be issued by the concessionaire itself, in which case the investors purchasing the security will become its creditors, or they may be issued by a third party to whom the project receivables have been assigned through a mechanism known as "securitization". Securitization involves the creation of financial securities backed by the project's revenue stream, which is pledged to pay the principal and interest of that security. Securitization transactions usually involve the establishment of a legal entity separate from the concessionaire and especially dedicated to the business of securitizing assets or receivables. This legal entity is often referred to as a "special-purpose vehicle". The concessionaire assigns project receivables to the special-purpose vehicle, which, in turn, issues to investors interest-bearing instruments that are backed by the project receivables. The securitized bondholders thereby acquire the right to the proceeds of the concessionaire's transactions with its customers. The concessionaire collects the tariffs from the customers and transfers the funds to the special-purpose vehicle, which then transfers it to the securitized bondholders. In some countries, recent legislation has expressly recognized the concessionaire's authority to assign project receivables to a special-purpose vehicle, which holds and manages the receivables for the benefit of the project's creditors. With a view to protecting the bondholders against the risk of insolvency of the concessionaire, it may be advisable to adopt the necessary legislative measures to enable the legal separation between the concessionaire and the special-purpose vehicle.

60. In most cases it would not be practical for the concessionaire to specify individually the receivables being assigned to the creditors. Assignment of receivables in project finance therefore typically takes the form of a bulk assignment of future receivables. Statutory provisions recognizing the concessionaire's authority to pledge the proceeds of infrastructure projects have been included in recent domestic legislation in various legal systems. 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. It is therefore important to ensure that domestic laws on security interests do not hinder the ability of the parties effectively to assign trade receivables in order to obtain financing for the project (see chap. VII, "Other relevant areas of law", ___).

4. Security over shares of the project company

61. Where the concession may not be assigned or transferred without the consent of the contracting authority (see paras.___), the law sometimes prohibits the establishment of security over the shares of the project company. It should be noted, however, that security over the shares of the project company is commonly required by lenders in project finance transactions and that general prohibitions on the establishment of such security may limit the project company's ability to raise funding for the project. As with other forms of security, it may therefore be useful for the law to authorize the concessionaire's shareholders to create such security, subject to the contracting authority's prior approval, where an approval would be required for the transfer of equity participation in the project company (see paras. 64-68).

F. ASSIGNMENT OF THE CONCESSION

62. Concessions are granted in view of the particular qualifications and reliability of the concessionaire and in most legal systems they are not freely transferable. Indeed, domestic laws often prohibit the assignment of the concession without the consent of the contracting authority. The purpose of these restrictions is typically to ensure the contracting authority's control over the qualifications of infrastructure operators or public service providers.

63. Some countries have found it useful to mention in the legislation the conditions under which approval for 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 to provide 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 contracting authority may be granted. However, it should be noted that restrictions typically apply to the voluntary transfer of its rights by the concessionaire; they do not preclude the compulsory transfer of the concession to an entity appointed by the lenders, with the consent of the contracting authority, for the purpose of averting termination due to serious default by the concessionaire (see also paras. 147-150).

G. TRANSFER OF CONTROLLING INTEREST IN THE PROJECT COMPANY

64. The contracting authority may be concerned that the original members of the bidding consortium maintain their commitment to the project throughout its duration and that effective control over the project company will not be transferred to entities unknown to the contracting authority. Concessionaires are selected to carry out infrastructure projects at least partly on the basis of their experience and capabilities for that sort of project (see chap. III, "Selection of the concessionaire", paras. 38-40). Contracting authorities are therefore concerned that, if the concessionaire's shareholders are entirely free to transfer their investment in a given project, there will be no assurance as to who will actually be delivering the relevant services.

65. Contracting authorities may draw reassurance from the experience that the selected bidding consortium demonstrated in the pre-selection phase and from the performance guarantees provided by the parent organizations of the original consortium and its subcontractors. In practice, however, the reassurance that may result from the apparent expertise of the shareholders in the concessionaire should not be overemphasized. Where a separate legal entity is established to carry out the project, which is often the case (see para. 12), the backing of the concessionaire's shareholders, should the project run into difficulties, may be limited to their maximum liability. Thus, restrictions on the transferability of investment, in and of themselves, may not represent sufficient protection against the risk of performance failure by the concessionaire. In particular, these restrictions are not a substitute for appropriate contractual remedies under the project agreement, such as monitoring of the level of service provided (see paras. 147-150) or termination without full compensation in case of unsatisfactory performance (see chap. V, "Duration, extension and termination of the project agreement", ___).

66. In addition to the above, restrictions on the transferability of shares in companies providing public services may also present some disadvantages for the contracting authority. As noted earlier (see "Introduction and background information on privately financed infrastructure projects", paras. 54-67), there are numerous types of funding available from different investors for different risk and reward profiles. The initial investors, such as construction companies and equipment suppliers, will seek to be rewarded for the higher risks they take on, while subsequent investors may require a lesser return commensurate with the reduced risks they bear. Most of the initial investors have finite resources and need to recycle capital in order to be able to participate in new projects. Therefore, those investors might not be willing to tie up capital in long-term projects. At the end of the construction period, the initial investors might prefer to sell their interest on to a secondary equity provider whose required rate of return is less. Once usage is more certain, another refinancing could take place. However, if the investors' ability to invest and reinvest capital for project development is restricted by constraints on the transferability of shares in infrastructure projects, there is a risk of a higher cost of funding. In some circumstances it may not be possible to fund a project at all, as some investors whose involvement may be crucial for the implementation of the project may not be willing to participate. From a long-term perspective, the development of a market place for investment in public infrastructure may be hindered if investors are unnecessarily constrained in the freedom to transfer their interest in privately financed infrastructure projects.

67. For the above reasons, it may be advisable to limit the restrictions on the transfer of a controlling interest in the project company to a certain period of time (for example, a certain number of years after the entry into force of the project agreement) or to situations where such restrictions are justified by reasons of public interest. One such situation may be where the concessionaire is in possession of public property or where the concessionaire receives loans, subsidies, equity or other forms of direct governmental support. In these cases, the contracting authority's accountability for the proper use of public funds requires assurances that the funds and assets are entrusted to a solid company, to which the original investors remain committed during a reasonable period. Another situation that may justify imposing limitations on the transfer of shares of concessionaire companies may be where the contracting authority has an interest in preventing transfer of shares to particular investors. For example, the contracting authority may wish to control acquisition of controlling shares of public service providers to avoid the formation of oligopolies or monopolies in liberalized sectors. Or it may not be thought appropriate for a company that had defrauded one part of Government to be employed by another through a newly acquired subsidiary.

68. In these exceptional cases it may be advisable to require that the initial investors seek the prior consent of the contracting authority before transferring their equity participation. It should be made clear in the project agreement that any such consent should not be unreasonably withheld or unduly delayed. For transparency purposes, it may also be advisable to establish the grounds for withholding approval and to require the contracting authority to specify in each instance the reasons for any refusal. The appropriate duration of such limitations—whether for a particular phase of the project or for the entire concession term—may need to be considered on a case-by-case basis. In some projects, it may be possible to relax such restrictions after the facility has been completed. It is also advisable to clarify in the project agreement whether these limitations, if any, should apply to the transfer of any participation in the concessionaire, or whether the concerns of the contracting authority will focus on one particular investor (such as. a construction company or the facility designer) while the construction phase lasts or for a significant time beyond.

H. CONSTRUCTION WORKS

69. Contracting authorities purchasing construction works typically act as the employer under a construction contract and retain extensive monitoring and inspection rights, including the right to review the construction project and request modifications to it, to follow closely the construction work and schedule, to inspect and formally accept the completed work and to give final authorization for the operation of the facility.

70. On the other hand, in many privately financed infrastructure projects, the contracting authority may prefer to transfer such responsibility to the concessionaire. Instead of assuming direct responsibility for managing the details of the project, the contracting authorities may prefer to transfer that responsibility to the concessionaire by requiring the latter to assume full responsibility for the timely completion of the construction. The concessionaire, too, will be interested in ensuring that the project is completed on time and that the cost estimate is not exceeded, and will typically negotiate fixed-price, fixed-time turnkey contracts that include guarantees of performance by the construction contractors. Therefore, in privately financed infrastructure projects it is the concessionaire that for most purposes performs the role that the employer would normally play under a construction contract.

71. For these reasons, legislative provisions on the construction of privately financed infrastructure facilities are in some countries limited to a general definition of the concessionaire's obligation to perform the public works in accordance with the provisions of the project agreement and give the contracting authority the general right to monitor the progress of the work with a view to ensuring that it conforms to the provisions of the agreement. In those countries, more detailed provisions are then left to the project agreement.

1. Review and approval of construction plans

72. Where it is felt necessary to deal with construction works and related matters in legislation, it is advisable to devise procedures that help to keep completion time and construction costs within estimates and lower the potential for disputes between the concessionaire and the public authorities involved. For instance, where statutory provisions require that the contracting authority review and approve the construction project, the project agreement should establish a deadline for the review of the construction project and provide that the approval shall be deemed to be granted if no objections are made by the contracting authority within the relevant period. It may also be useful to set out in the project agreement the grounds on which the contracting authority may raise objections to or request modifications in the project, such as safety, defence, security, environmental concerns or non-conformity with the specifications.

2. Variation in the project terms

73. During the course of construction of an infrastructure facility, it is common for situations to arise that make it necessary or advisable to alter certain aspects of the construction. The contracting authority may therefore wish to retain the right to order changes in respect of such aspects as the scope of construction, the technical characteristics of equipment or materials to be incorporated in the work or the construction services required under the specifications. Such changes are referred to in this *Guide* as "variations". As used in the *Guide*, the word "variation" does not include tariff adjustments or revisions made as a result of cost changes or currency fluctuations (see paras. 39-44). Likewise, renegotiation of the project agreement in cases of substantial change in conditions (see paras. 126-130) is not regarded in the *Guide* as a variation.

74. Given the complexity of most infrastructure projects, it is not possible to exclude the need for variations in the construction specifications or other requirements of the project. However, such variations often cause delay in the execution of the project or in the delivery of the public service; they may also render the performance under the project agreement more onerous for the concessionaire. Furthermore, the cost of implementing extensive variation orders may exceed the concessionaire's own financial means, thus requiring substantial additional funding that may not be obtainable at an acceptable cost. It is therefore advisable for the contracting authority to consider measures to control the possible need for variations. The quality of the feasibility studies required by the contracting authority and of the specifications provided during the selection process (see chap. III, "Selection of the concessionaire", paras. 61 and 64-66) play an important role in avoiding subsequent changes in the project.

75. The project agreement should set forth the specific circumstances under which the contracting authority may order variations in respect of construction specifications and the compensation that may be due to the concessionaire, as appropriate, to cover the additional cost and delay

entailed by implementing the variations. The project agreement should also clarify the extent to which the concessionaire is obliged to implement those variations and whether the concessionaire may object to variations and, if so, on which grounds. According to the contractual practice of some legal systems, the concessionaire may be released of its obligations when the amount of additional costs entailed by the modification exceeds a set maximum limit.

76. Various contractual approaches for dealing with variations have been used in large construction contracts to deal with the extent of the contractor's obligation to implement changes and the required adjustments in the contract price or contract duration. Such solutions may also be used, mutatis mutandis, to deal with variations sought by the contracting authority under the project agreement.[1] It should be noted, however, that in infrastructure concessions the project company's payment consists of user fees or prices for the output of the facility, rather than a global price for the construction work. Thus, compensation methods used in connection with infrastructure concessions sometimes include a combination of various methods, ranging from lump-sum payments to tariff increases, or extensions of the concession period. For instance, there may be changes that result in an increase in the cost that the concessionaire may be able to absorb and finance itself and amortize by means of an adjustment in the tariff or payment mechanism, as appropriate. If the concessionaire cannot refinance or fund the changes itself, the parties may wish to consider lump-sum payments as an alternative to an expensive and complicated refinancing structure.

3. Monitoring powers of the contracting authority

77. In some legal systems, public authorities purchasing construction works customarily retain the power to order the suspension or interruption of the works for reasons of public interest. However, with a view to providing some reassurance to potential investors, it may be useful to limit the possibility of such interference and to provide that no such interruption should be of a duration or extent greater than is necessary, taking into consideration circumstances that gave rise to the requirement to suspend or interrupt the work. It may also be useful to agree on a maximum period of suspension and to provide for appropriate compensation to the concessionaire. Furthermore, guarantees may be provided to ensure payment of compensation or to indemnify the concessionaire for loss resulting from suspension of the project (see also chap. II, "Project risks and government support", paras. 48-50).

78. In some legal systems, facilities built for use in connection with the provision of certain public services become public property once construction is finished (see para. 24). In such cases, the law often requires that the completed facility be formally accepted by the contracting authority or another public authority. Such formal acceptance is typically given only after inspection of the completed facility and satisfactory conclusion of the necessary tests to ascertain that the facility is operational and meets the specifications and technical and safety requirements. Even where formal acceptance by the contracting authority is not required (for example, where the facility remains the property of the concessionaire), provisions concerning final inspection and approval of the construction work by the contracting authority are often required in order to ensure compliance with health, safety, building or labour regulations. The project agreement should set out in detail the nature of the completion tests or the inspection of the completed facility; the timetable for the tests (for instance, it may be appropriate to undertake partial tests over a period, rather than a single test at the end); the consequences of failure to pass a test; and the responsibility for organizing the resources for the test and covering the corresponding costs. In some countries, it has been found useful to authorize the facility to operate on a provisional basis, pending final approval by the contracting authority, and to provide an opportunity for the concessionaire to rectify defects that might be found at that juncture.

4. Guarantee period

79. The construction contracts negotiated by the concessionaire will typically provide for a quality guarantee under which the contractors assume liability for defects in the works and for inaccuracies or insufficiencies in technical documents supplied with the works, except for reasonable exclusions (such as normal wear and tear or faulty maintenance or operation by the concessionaire). Additional liability may also derive from statutory provisions or general principles of law under the applicable law, such as a special extended liability period for structural defects in works, which is provided in some legal systems. The project agreement should provide that final approval or acceptance of the facility by the contracting authority will not release the construction contractors from any liability for defects in the works and for inaccuracies or insufficiencies in technical documents that may be provided under the construction contracts and the applicable law.

I. OPERATION OF INFRASTRUCTURE

80. Conditions for the operation and maintenance of the facility, as well as for quality and safety standards, are often enumerated in the law and spelled out in detail in the project agreement. In addition, especially in the fields of electricity, water and sanitation and public transportation, the contracting authority or an independent regulatory agency may exercise an oversight function over the operation of the facility. An exhaustive discussion of legal issues relating to the conditions of operation of infrastructure facilities would exceed the scope of this *Guide*. The following paragraphs therefore contain only a brief presentation of some of the main issues.

81. Regulatory provisions on infrastructure operation and legal requirements for the provision of public services are intended to achieve various objectives of public relevance.

[1] For a discussion of approaches and possible solutions used in construction contracts for complex industrial works, see the *UNCITRAL Legal Guide on Drawing Up Contracts for the Construction of Industrial Works* (United Nation publication, Sales No. E.87.V.10), chap. XXIII, "Variation clauses".

Given the usually long duration of infrastructure projects, there is a possibility that such provisions and requirements may need to be changed during the life of the project agreement. It is important, however, to bear in mind the private sector's need for a stable and predictable regulatory framework. Changes in regulations or the frequent introduction of new and stricter rules may have a disruptive impact on the implementation of the project and compromise its financial viability. Therefore, while contractual arrangements may be agreed to by the parties to counter the adverse effects of subsequent regulatory changes (see paras. 122-125), regulatory agencies would be well advised to avoid excessive regulation or unreasonably frequent changes in existing rules.

1. Performance standards

82. Public service providers generally have to meet a set of technical and service standards. Such standards are in most cases too detailed to figure in legislation and may be included in implementing decrees, regulations or other instruments. Service standards are often spelled out in great detail in the project agreement. They include quality standards, such as requirements with respect to water purity and pressure; ceilings on the length of time to perform repairs; ceilings on the number of defects or complaints; timely performance of transport services; continuity in supply; and health, safety and environmental standards. Legislation may, however, impose the basic principles that will guide the establishment of detailed standards or require compliance with international standards.

83. The contracting authority typically retains the power to monitor the adherence of the project company to the regulatory performance standards. The concessionaire will be interested in avoiding as much as possible any interruption in the operation of the facility and in protecting itself against the consequences of any such interruption. It will seek assurances that the exercise by the contracting authority of its monitoring or regulatory powers does not cause undue disturbance or interruption in the operation of the facility and that it does not result in undue additional costs to the concessionaire.

2. Extension of services

84. In some legal systems, an entity operating under a governmental concession to provide certain essential services such as electricity or potable water to a community or territory and its inhabitants is held to assume an obligation to provide a service system that is reasonably adequate to meet the demand of the community or territory. That obligation often relates not only to the historical demand at the time the concession was awarded, but implies an obligation to keep pace with the growth of the community or territory served and gradually to extend the system as may be required by the reasonable demand of the community or territory.

85. In some legal systems, the obligation has the nature of a public duty that may be invoked by any resident of the relevant community or territory. In other legal systems, it has the nature of a statutory or contractual obligation that may be enforced by the contracting authority or by a regulatory agency, as the case may be. In some legal systems, this obligation is not absolute and unqualified. The concessionaire's duty to extend its service facilities may indeed depend upon various factors, such as the need and cost of the extension and the revenue that may be expected as a result of the extension; the concessionaire's financial situation; the public interest in effecting such an extension; and the scope of the obligations assumed by the concessionaire in that regard under the project agreement. In some legal systems, the concessionaire may be under an obligation to extend its service facilities even if the particular extension is not immediately profitable or even if, as a result of the extensions being carried out, the concessionaire's territory might eventually include unprofitable areas. That obligation is nevertheless subject to some limits, since the concessionaire is not required to carry out extensions that place an unreasonable burden on it or its customers. Depending on the particular circumstances, the cost of carrying out extensions of service facilities may be absorbed by the concessionaire, passed on to the customers or end users in the form of tariff increases or extraordinary charges or absorbed in whole or in part by the contracting authority or other public authority by means of subsidies or grants. Given the variety of factors that may need to be taken into account in order to assess the reasonableness of any particular extension, the project agreement should define the circumstances under which the concessionaire may be required to carry out extensions in its service facilities and the appropriate methods for financing the cost of any such extension.

3. Continuity of service

86. Another obligation of public service providers is to ensure the continuous provision of the service under most circumstances, except for narrowly defined exempting events (see also paras. 132-134). In some legal systems, that obligation has the nature of a statutory duty that applies even if it is not expressly stated in the project agreement. The corollary of that rule, in legal systems where it exists, is that various circumstances under general principles of contract law might authorize a contract party to suspend or discontinue the performance of its obligations, such as economic hardship or breach by the other party, cannot be invoked by the concessionaire as grounds for suspending or discontinuing, in whole or in part, the provision of a public service. In some legal systems, the contracting authority may even have special enforcement powers to compel the concessionaire to resume providing service in the event of unlawful discontinuance.

87. That obligation, too, is subject to a general rule of reasonableness. Various legal systems recognize the concessionaire's right to fair compensation for having to deliver the service under situations of hardship (see paras. 126-130). Moreover, in some legal systems, it is held that a public service provider may not be required to operate where its overall operation results in a loss. Where the public service as a whole, and not only one or more of its

branches or territories, ceases being profitable, the concessionaire may have the right to direct compensation by the contracting authority or, alternatively, the right to terminate the project agreement. However, termination typically requires the consent of the contracting authority or a judicial decision. In legal systems that allow such a solution, it is advisable to clarify in the project agreement which extraordinary circumstances would justify the suspension of the service or even release the concessionaire from its obligations under the project agreement (see also chap. V, "Duration, extension and termination of the project agreement", ___).

4. Equal treatment of customers or users

88. Entities that provide certain services to the general public are, in some jurisdictions, under a specific obligation to ensure the availability of the service under essentially the same conditions to all users and customers falling within the same category. However, differentiation based on a reasonable and objective classification of customers and users is accepted in those legal systems as long as like contemporaneous service is rendered to consumers and users engaged in like operations under like circumstances. It may thus not be inconsistent with the principle of equal treatment to charge different prices or to offer different access conditions to different categories of users (for example, domestic consumers, on the one hand, and business or industrial consumers, on the other), provided that the differentiation is based on objective criteria and corresponds to actual differences in the situation of the consumers or the conditions under which the service is provided to them. Nevertheless, where a difference in charges or other conditions of service is based on actual differences in service (such as higher charges for services provided at hours of peak consumption), it typically has to be commensurate with the amount of difference.

89. In addition to differentiation established by the concessionaire itself, different treatment of certain users or customers may be the result of legislative action. In many countries, the law requires that specific services must be provided at particularly favourable terms to certain categories of users and customers, such as discounted transport for schoolchildren or senior citizens, or reduced water or electricity rates for lower-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 more profitable services (see chap. II, "Project risks and government support", paras. 42-44).

5. Interconnection and access to infrastructure networks

90. Companies operating infrastructure networks in sectors such as railway transport, telecommunications or power or gas supply are sometimes required to allow other companies to have access to the network. That requirement may be stated in the project agreement or in sector-specific laws or regulations. Interconnection and access requirements have been introduced in certain infrastructure sectors as a complement to reforms in the structure of a given sector; in others, they have been adopted to foster competition in sectors that remained fully or partially integrated (for a brief discussion of market structure issues, see "Introduction and background information", paras. 21-46).

91. Network operators are often required to provide access on terms that are fair and non-discriminatory from a financial as well as a technical point of view. Non-discrimination implies that the new entrant or service provider should be able 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 those of competing providers. It should be noted, however, that many pipeline access regimes, for example, 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.

92. While access pricing is usually cost-based, regulatory agencies often retain the right to monitor access tariffs to ensure that they are high enough to give adequate incentive to invest in the required infrastructure and low enough to allow new entrants to compete on fair terms. Where the network operator provides services in competition with other providers, there may be requirements 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 of it.

93. Technical access conditions may be equally important and network operators 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 it needs, such as the local telecommunications loop, transmission capacity for the supply of electricity or the use of a track section of railway.

6. Disclosure requirements

94. Many domestic laws impose on public service providers an obligation to provide to the regulatory agency accurate and timely information on their operations and to grant it specific enforcement rights. The latter may encompass inquiries and audits, including detailed performance and compliance audits, sanctions for non-cooperative companies and injunctions or penalty procedures to enforce disclosure.

95. Public service providers are normally required to maintain and disclose to the regulatory agency their financial accounts and statements and to maintain detailed cost accounting allowing the regulatory agency to track various aspects of the company's activities separately. Financial transactions between the concessionaire company and affiliated companies may also require scrutiny, as concessionaire companies may try to transfer profits to non-regulated businesses or foreign affiliates. Infrastructure operators may also have detailed technical and performance reporting requirements. As a general rule, however, it is important to define reasonable limits to the extent and type of information that infrastructure operators are required to submit. Furthermore, appropriate measures should be taken to protect the confidentiality of any proprietary information that the concessionaire and its affiliated companies may submit to the regulatory agency.

7. Enforcement powers of the concessionaire

96. In countries with a well-established tradition of awarding concessions for the provision of public services, the concessionaire may have the power to establish rules designed to facilitate the provision of the service (such as instructions to users or safety rules), take reasonable measures to ensure compliance with those rules and suspend the provision of service for emergency or safety reasons. For that purpose, general legislative authority, or even case-by-case authorization from the legislature, may be required in most legal systems. The extent of powers given to the concessionaire is usually defined in the project agreement, however, and may not need to be provided in detail in legislation. It may be advisable to provide that the rules issued by the concessionaire become effective upon approval by the regulatory agency or the contracting authority, as appropriate. However, the right to approve operating rules proposed by the concessionaire should not be arbitrary and the concessionaire should have the right to appeal a decision to refuse approval of the proposed rules (see also chap. I, "General legislative and institutional framework", paras. 49 and 50).

97. Of particular importance for the concessionaire is the question whether the provision of the service may be discontinued because of default or non-compliance by its users. Despite the concessionaire's general obligation to ensure the continuous provision of the service (see paras. 86 and 87), many legal systems recognize that entities providing public services may establish and enforce rules that provide for shutting off of the service for a consumer or user who has defaulted in payment for it or who has seriously infringed the conditions for using it. The power to do so is often regarded as crucial in order to prevent abuse and ensure the economic viability of the service. However, given the essential nature of certain public services, that power may require legislative authority in some legal systems. Furthermore, there may be a number of expressed or implied limitations upon or conditions for the exercise of that power, such as special notice requirements and specific consumer remedies. Additional limitations and conditions may derive from the application of general consumer protection rules (see chap. VII, "Other relevant areas of law", ___).

J. GENERAL CONTRACTUAL ARRANGEMENTS

98. This section discusses selected contractual arrangements that typically appear in project agreements in various sectors and are often reflected in standard contract clauses used by domestic contracting authorities. Although essentially contractual in nature, the arrangements discussed in this section may have some important implications for the legislation of the host country, according to its particular legal system.

1. Subcontracting

99. Given the complexity of infrastructure projects, the concessionaire typically retains the services of one or more construction contractors to perform some or the bulk of the construction work under the project agreement. The concessionaire may also wish to retain the services of contractors with experience in the operation and maintenance of infrastructure during the operational phase of the project. The laws of some countries generally acknowledge the concessionaire's right to enter into contracts as needed for the execution of the construction work. A legislative provision recognizing the concessionaire's authority to subcontract may be particularly useful in countries where there are limitations to the ability of government contractors to subcontract.

(a) Choice of subcontractors

100. The concessionaire's freedom to hire subcontractors is in some countries restricted by rules that prescribe the use of tendering and similar procedures for the award of subcontracts by public service providers. Such statutory rules have often been adopted when infrastructure facilities were primarily or exclusively operated by the Government, with little or only marginal private sector investment. The purpose of such statutory rules is to ensure economy, efficiency, integrity and transparency in the use of public funds. However, in the case of privately financed infrastructure projects, such provisions may discourage the participation of potential investors, since the project sponsors typically include engineering and construction companies that participate in the project in the expectation that they will be given the main contracts for the execution of the construction and other work.

101. The concessionaire's freedom to select its subcontractors is not unlimited, however. In some countries, the concessionaire has to identify in its proposal which contractors will be retained, including information on their technical capability and financial standing. Other countries either require that such information be provided at the time the project agreement is concluded or subject such contracts to prior review and approval by the contracting authority. The purpose of such provisions is to avoid possible conflicts of interest between the project company and its shareholders, a point that would normally also be of interest to the lenders, who may wish to ensure that the project company's contractors are not overpaid. In any event, if it is deemed necessary for the contracting authority to have the right to review and approve the project company's subcontracts, the project agreement should clearly define the purpose of such review and approval procedures and the

circumstances under which the contracting authority's approval may be withheld. As a general rule, approval should not normally be withheld unless the subcontracts are found to contain provisions manifestly contrary to the public interest (for example, provisions for excessive payments to subcontractors or unreasonable limitations of liability) or contrary to mandatory rules having the nature of public law that apply to the execution of privately financed infrastructure projects in the host country.

(b) Governing law

102. It is common for the concessionaire and its contractors to choose a law that is familiar to them and that in their view adequately governs the issues addressed in their contracts. Depending upon the type of contract, different issues concerning the governing law clause will arise. For example, equipment supply and other contracts may be entered into with foreign companies and the parties may wish to choose a law known to them as providing, for example, an adequate warranty regime for equipment failure or non-conformity of equipment. In turn, the concessionaire may agree to the application of the laws of the host country in connection with contracts entered into with local customers.

103. Domestic laws specific to privately financed infrastructure projects seldom contain provisions concerning the law governing the contracts entered into by the concessionaire. In fact, most countries have found no compelling reason for making specific provisions concerning the law governing the contracts between the concessionaire and its contractors and have preferred to leave the question to a choice-of-law clause in their contracts or to the applicable rules of private international law. It should be noted, however, that the freedom to choose the applicable law for contracts and other legal relationships is in some legal systems subject to conditions and restrictions pursuant to rules of private international law or certain rules of public law of the host country. For instance, States parties to some regional economic integration agreements are obliged to enact harmonized provisions of private international law dealing, inter alia, with contracts between public service providers and their contractors. While rules of private international law often allow considerable freedom to choose the law governing commercial contracts, that freedom is in some countries restricted for contracts and legal relationships that are not qualified as commercial, such as, for instance, certain contracts entered into by public authorities of the host country (for example, guarantees and assurances by the Government, power purchase or fuel supply commitments by a public authority) or contracts with consumers.

104. In some cases, provisions have been included in domestic legislation for the purpose of clarifying, as appropriate, that the contracts entered into between the concessionaire and its contractors are governed by private law and that the contractors are not agents of the contracting authority. A provision of that type may in some countries have a number of practical consequences, such as no subsidiary liability of the contracting authority for the acts of the subcontractors or No obligation on the part of the responsible public entity to pay worker's compensation for work-related illness, injury or death to the subcontractors' employees.

2. Liability with respect to users and third parties

105. Defective construction or operation of an infrastructure facility may result in the death of or personal injury to employees of the concessionaire, users of the facility or other third parties or in damage to their property. The issues concerning damages to be paid to third parties in such cases are complex and may be governed not by rules of the law applicable to the project agreement governing contractual liability, but rather by applicable legal rules governing extra-contractual liability, which are often mandatory. Also, in some legal systems, there are special mandatory rules governing the extra-contractual liability of public authorities to which the contracting authority may be subject. Moreover, the project agreement cannot limit the liability of the concessionaire or the contracting authority to compensate third parties who are not parties to the project agreement. It is therefore advisable for the contracting authority and the concessionaire to provide for the internal allocation of risks between them as regards damages to be paid to third parties due to death, personal injury or damage to their property, to the extent that this allocation is not governed by mandatory rules. It is also advisable for the parties to provide for insurance against such risks (see paras. 119 and 120).

106. If a third party suffers personal injury or damage to its property as a result of the construction or operation of the facility and brings a claim against the contracting authority, the law may provide that the concessionaire alone should bear any responsibility in that regard and that contracting authority should not bear any liability as regards such third party claims, except where the damage was caused by the serious default or recklessness of the contracting authority. It may be useful to provide, in particular, that the mere approval of the design or specification of the facility by the contracting authority or its acceptance of the construction works or final authorization for the operation of the facility or its use by the public does not entail the assumption by the contracting authority of any liability for damage sustained by users of the facility or other third parties arising out of the construction or operation of the facility or the inadequacy of the approved design or specifications. Moreover, since provisions on the allocation of liability may not be enforceable against third parties under the applicable law, it may be advisable for the project agreement to provide that the contracting authority should be protected and indemnified in respect of compensation claims brought by third parties who sustain injury or damage to their property resulting from the construction or operation of the infrastructure facility.

107. The project agreement should also provide that the parties should inform each other of any claim or proceedings or anticipated claims or proceedings against them in respect of which the contracting authority is entitled to be indemnified and give reasonable assistance to one another in the defence of such claims or proceedings to the extent permitted by the law of the country where such proceedings are instituted.

3. Performance guarantees and insurance

108. The obligations of the concessionaire are usually complemented by the provision of some form of guarantee of performance in the event of default and insurance coverage against a number of risks. The law in some countries generally requires that adequate guarantees of performance be provided by the concessionaire and refer the matter to the project agreement for further details. In other countries, the law contains more detailed provisions, for instance requiring the offer of a certain type of guarantee up to a stated percentage of the basic investment.

(a) Types, functions and nature of performance guarantees

109. Performance guarantees are generally of two types. Under one type, the monetary performance guarantee, the guarantor undertakes only to pay the contracting authority funds up to a stated limit to satisfy the liabilities of the concessionaire in the event of the latter's failure to perform. Monetary performance guarantees may take the form of a contract bond, a stand-by letter of credit or an on-demand guarantee. Under the other type of guarantee, the performance bond, the guarantor chooses one of two options: *(a)* to rectify defective or finish incomplete construction itself; or *(b)* to obtain another contractor to rectify defective or finish incomplete construction and compensate the contracting authority for losses caused by the failure to perform. The value of such an undertaking is limited to a stated amount or a certain percentage of the contract value. Under a performance bond, the guarantor also frequently reserves the option to discharge its obligations solely by the payment of money to the contracting authority. Performance bonds are generally furnished by specialized guarantee institutions, such as bonding and insurance companies. A special type of performance bond is the maintenance bond, which protects the contracting authority against future failures that could arise during the start-up or maintenance period and serve as guarantee that any repair or maintenance work during the post-completion warranty period will be duly carried out by the concessionaire.

110. As regards their nature, performance guarantees may be generally divided into independent guarantees and accessory guarantees. A guarantee is said to be "independent" if the guarantor's obligation is independent from the concessionaire's obligations under the project agreement. Under an independent guarantee (often called a first-demand guarantee) or a stand-by letter of credit, the guarantor or issuer is obligated to make payment on demand by the beneficiary and the latter is entitled to recover under the instrument if it presents the document or documents stipulated in the terms of the guarantee or stand-by letter of credit. Such a document might be simply a statement by the beneficiary that the contractor has failed to perform. The guarantor or issuer is not entitled to withhold payment on the ground that there has in fact been no failure to perform under the main contract; however, under the law applicable to the instrument, payment may in very exceptional and narrowly defined circumstances be refused or restrained (for example, when the claim by the beneficiary is manifestly fraudulent). In contrast, a guarantee is accessory when the obligation of the guarantor involves more than the mere examination of a documentary demand for payment in that the guarantor may have to evaluate evidence of liability of the contractor for failure to perform under the works contract. The nature of the link may vary under different guarantees and may include the need to prove the contractor's liability in arbitral proceedings. By their nature, performance bonds have an accessory character to the underlying contract.

(b) Advantages and disadvantages of various types of performance guarantee

111. From the perspective of the contracting authority, monetary performance guarantees may be particularly useful in covering additional costs that may be incurred by the contracting authority as a result of delay or default by the concessionaire. Monetary performance guarantees may also serve as an instrument to put pressure on the concessionaire to complete construction in time and to perform its other obligations in accordance with the requirements of the project agreement. However, the amount of those guarantees is typically only a fraction of the economic value of the obligation guaranteed and is usually not sufficient to cover the cost of engaging a third party to perform instead of the concessionaire or its contractors.

112. From the perspective of the contracting authority, a first-demand guarantee has the advantage of assuring prompt recovery of funds under the guarantee, without evidence of failure to perform by the contractor or of the extent of the beneficiary's loss. Furthermore, guarantors furnishing monetary performance guarantees, in particular banks, prefer first-demand guarantees, as the conditions are clear as to when their liability to pay accrues, and the guarantors will thus not be involved in disputes between the contracting authority and the concessionaire as to whether or not there has been a failure to perform under the project agreement. Another advantage for a bank issuing a first-demand guarantee is the possibility of quick and efficient recovery of the sums paid under a first-demand guarantee by direct access to the concessionaire's assets.

113. A disadvantage to the contracting authority of a first-demand guarantee or a stand-by letter of credit is that those instruments may increase the overall project costs, since the concessionaire is usually obliged to obtain and set aside large counter-guarantees in favour of the institutions issuing the first-demand guarantee or the stand-by letter of credit. Also, a concessionaire that furnishes such a guarantee may wish to take out insurance against the risk of recovery by the contracting authority under the guarantee or the stand-by letter of credit when there has been in fact no failure to perform by the concessionaire and the cost of that insurance is included in the project cost. The concessionaire also may include in the project cost the potential costs of any action that it may need to institute against the contracting authority to obtain the repayment of the sum improperly claimed.

114. A disadvantage to the concessionaire of a first-demand guarantee or a stand-by letter of credit is that, if there is recovery by the contracting authority when there has been no failure to perform by the concessionaire, the latter may suffer immediate loss if the guarantor or the issuer of the letter of credit reimburses itself from the assets of the concessionaire after payment to the contracting authority. The concessionaire may also experience difficulties and delays in recovering from the contracting authority the sum improperly claimed.

115. The terms of an accessory guarantee usually require the beneficiary to prove the failure of the contractor to perform and the extent of the loss suffered by the beneficiary. Furthermore, the defences available to the debtor if it is sued for a failure to perform are also available to the guarantor. Accordingly, there is a risk that the contracting authority may face a protracted dispute when it makes a claim under the bond. In practice, this risk may be reduced, for instance, if the submission of claims under the terms of the bond is subject to a procedure such as that provided in article 7 *(j)*(i) of the Uniform Rules on Contract Bonds, drawn up by the International Chamber of Commerce.[2] Article 7 *(j)*(i) of the Uniform Rules provides that notwithstanding any dispute or difference between the principal and the beneficiary in relation to the performance of the contract or any contractual obligation, a default for the purposes of payment of a claim under a contract bond shall be deemed to be established upon issue of a certificate of default by a third party (who may without limitation be an independent architect or engineer or referee) if the bond so provides and the service of such a certificate or a certified copy thereof upon the guarantor. Where such a procedure is adopted, the contracting authority may be entitled to obtain payment under the contract bond even though its entitlement to that payment is disputed by the concessionaire.

116. As a reflection of the lesser risk borne by the guarantor, the monetary limit of liability of the guarantor may be considerably higher than under a first-demand guarantee, thus covering a larger percentage of work under the project agreement. A performance bond may also be advantageous if the contracting authority cannot conveniently arrange for the rectification of faults or completion of construction itself and requires the assistance of a third party to arrange for rectification or completion. Where, however, the construction involves the use of a technology known only to the concessionaire, rectification or completion by a third person may not be feasible and a performance bond may not have the last-mentioned advantage over a monetary performance guarantee. For the concessionaire, accessory guarantees have the advantage of preserving the concessionaire's borrowing power, since accessory guarantees, unlike first-demand guarantees and stand-by letters of credit, do not affect the concessionaire's line of credit with the lenders.

117. It flows from the above considerations that different types of guarantees may be useful in connection with the various obligations assumed by the concessionaire. While it is useful to require the concessionaire to provide adequate guarantees of performance, it is advisable to leave it to the parties to determine the extent to which guarantees are needed and which guarantees should be provided in respect of the various obligations assumed by the concessionaire, rather than requiring in the law only one form of guarantee to the exclusion of others. It should be noted that the project company itself will require a series of performance guarantees to be provided by its contractors (see para. 6) and that additional guarantees to the benefit of the contracting authority usually increase the overall cost and complexity of a project. In some countries, practical guidance provided to domestic contracting authorities advises them to consider carefully whether and under what circumstances such guarantees are required, which specific risks or loss they should cover and which type of guarantee is best suited in each case. The ability of the project company to raise finance for the project may be jeopardized by bond requirements set at an excessive level.

118. One particular problem of privately financed infrastructure projects concerns the duration of the guarantee. The contracting authority may have an interest in obtaining guarantees of performance that remain valid during the entire life of the project, covering both the construction and the operational phase. However, given the long duration of infrastructure projects and the difficulty in evaluating the various risks that may arise, it may be problematic for the guarantor to issue a performance bond for the whole duration of the project or to procure reinsurance for its obligations under the performance bond. In practice, this problem is compounded by stipulations that the non-renewal of a performance bond constitutes a reason for a call on the bond, so that merely allowing the project company to provide bonds for shorter periods may not be a satisfactory solution. One possible solution, used in some countries, is to require separate bonds for the construction and the operation phase, thus allowing for better assessment of risks and reinsurance prospects. Such a system may be enhanced by defining in precise terms the risk to be covered during the operation period, thus allowing for a better assessment of risks and a reduction of the total amount of the bond. Another possibility to be considered by the contracting authority may be to require the provision of performance guarantees during specific crucial periods, rather than for the entire duration of the project. For instance, a bond might be required during the construction phase and last for an appropriate period beyond completion, so as to cover possible latent defects. Such a bond might then be replaced by a performance bond for a certain number of years of operation, as appropriate in order for the project company to demonstrate its capability to operate the facility in accordance with the required standards. If the project company's performance proves to be satisfactory, the bond requirement might be waived for the remainder of the operation phase, up to a certain period before the end of the concession term, when the project company might be required to place another bond to guarantee its obligations in connection with the handing over of assets and other measures for the orderly wind-up of the project, as appropriate (see chap. V, "Duration, extension and termination of the project agreement", ___).

[2]The text of the Uniform Rules on Contract Bonds is reproduced in document A/CN.9/459/Add.1.

(c) Insurance arrangements

119. Insurance arrangements made in connection with privately financed infrastructure projects typically vary according to the phase to which they apply, with certain types of insurance only being purchased during a particular project phase. Some forms of insurance, such as business interruption insurance, may be purchased by the concessionaire in its own interest, while other forms of insurance may be a requirement under the laws of the host country. Forms of insurance often required by law include insurance coverage against damage to the facility, third-party liability insurance, workers' compensation insurance and pollution and environmental damage insurance.

120. Mandatory insurance policies under the laws of the host country often need to be obtained from a local insurance company or from another institution admitted to operate in the country, which in some cases may pose a number of practical difficulties. In some countries, the type of coverage usually offered may be more limited than the standard coverage available on the international market, in which case the concessionaire may remain exposed to a number of perils that may exceed its self-insurance capacity. That risk is particularly serious in connection with environmental damage insurance. Further difficulties may arise in some countries as a result of limitations on the ability of local insurers to reinsure the risks on the international insurance and reinsurance markets. As a consequence, the project company may often need to procure additional insurance outside the country, thus adding to the overall cost of financing the project.

4. Changes in conditions

121. Privately financed infrastructure projects normally last for a long period of time, during which many circumstances relevant to the project may change. The impact of many changes may be automatically covered in the project agreement, either through financial arrangements such as a tariff structure that includes an indexation clause (see paras. 39-46), or by the assumption by either party, expressly or by exclusion, of certain risks (for example, if the price of fuel or electricity supply is not taken into account in the indexation mechanisms, then the risk of higher than expected prices is absorbed by the concessionaire). However, there are changes that might not lend themselves easily to inclusion in an automatic adjustment mechanism or that the parties may prefer to exclude from such a mechanism. From a legislative perspective, two particular categories deserve special attention: legislative or regulatory changes and unexpected changes in economic conditions.

(a) Legislative and regulatory changes

122. Given the long duration of privately financed infrastructure projects, the concessionaire may face additional costs in meeting its obligations under the project agreement because of future, unforeseen changes in legislation applying to its activities. In extreme cases, legislation could even make it financially or physically impossible for the concessionaire to carry on with the project. For the purpose of considering the appropriate solution for dealing with legislative changes, it may be useful to distinguish between legislative changes having a particular incidence on privately financed infrastructure projects or on one specific project, on the one hand, and general legislative changes affecting other economic activities also, and not only infrastructure operation, on the other hand.

123. All business organizations, in the private and public sectors alike, are subject to changes in law and generally have to deal with the consequences that such changes may have for business, including the impact of changes on the price of or demand for their products. Possible examples might include changes in the structure of capital allowances that apply to entire classes of assets, whether owned by the public or private sector and whether related to infrastructure projects or not; regulations that affect the health and safety of construction workers on all construction projects, not just infrastructure projects; and changes in the regulations on the disposal of hazardous substances. General changes in law may be regarded as an ordinary business risk rather than a risk specific to the concessionaire's activities and it may be difficult for the Government to undertake to protect infrastructure operators from the economic and financial consequences of changes in legislation that affect other business organizations equally. Thus, there may not be a prima facie reason why the concessionaire should not bear the consequences of general legislative risks, including the risk of costs arising from changes in law applying to the whole business sector.

124. Nevertheless, it is important to take into account possible limitations in the concessionaire's capacity to respond to or absorb cost increases that result from general legislative changes. Infrastructure operators are often subject to service standards and tariff control mechanisms that make it difficult for them to respond to changes in the law in the same manner as other private companies (by increasing tariffs or by reducing services, for example). Where tariff control mechanisms are provided in the project agreement, the concessionaire will seek to obtain assurances from the contracting authority and the regulatory agency, as appropriate, that it will be allowed to recover the additional costs entailed by changes in legislation by means of tariff increases. Where such an assurance cannot be given, it is advisable to empower the contracting authority to negotiate with the concessionaire the compensation to which the concessionaire may be entitled in the event that tariff control measures do not allow for full recovery of the additional costs generated by general legislative changes.

125. A different situation arises when the concessionaire faces increased costs as a result of specific legislative changes that target the particular project, a class of similar projects or privately financed infrastructure projects in general. Such changes cannot be regarded as an ordinary business risk and may significantly alter the economic and financial assumptions based on which the project agreement was negotiated. Thus, the contracting authority often agrees to bear the additional cost resulting from specific legisla-

tion that targets the particular project, a class of similar projects or privately financed infrastructure projects in general. For example, in highways projects, legislation aimed at a specified road project or road operating company, or at that class of privately operated road projects, might result in a tariff adjustment under the relevant provisions in the project agreement.

(b) Changes in economic conditions

126. Some legal systems have rules that allow a revision of the terms of the project agreement following changes in the economic or financial conditions that, without preventing the performance of a party's contractual obligations, render the performance of those obligations substantially more onerous than originally foreseen at the time they were entered into. In some legal systems, the possibility of a revision of the terms of the agreement is generally implied in all Government contracts or is expressly provided for in the relevant legislation.

127. The financial and economic considerations for the concessionaire's investment are negotiated in the light of assumptions based on the circumstances prevailing at the time of the negotiations and the reasonable expectations of the parties as to how those circumstances will evolve during the life of the project. To a certain extent, projections of economic and financial parameters and sometimes even a certain margin of risk, will normally be included in the formulation of the financial proposals by the bidders (see chap. III, "Selection of the concessionaire", para. 68). However, certain events may occur that the parties could not reasonably have anticipated when the project agreement was negotiated and that, had they been taken into account, would have resulted in a different risk allocation or consideration for the concessionaire's investment. Given the long duration of infrastructure projects, it is important to devise mechanisms to deal with the financial and economic impact of such events. Revision rules have been applied in a number of countries and have been found useful to help parties find equitable solutions for ensuring the continued economic and financial viability of infrastructure projects, thus averting a disruptive failure of performance by the concessionaire. However, revision rules may also have some disadvantages, in particular from the perspective of the Government.

128. As with general legislative changes, changes in economic conditions are risks to which most business organizations are exposed without having recourse to a general guarantee of the Government that would protect them against the economic and financial effects of those changes. An unqualified obligation of the contracting authority to compensate the concessionaire for changes of economic conditions may result in a reversion to the public sector of a substantial portion of the commercial risks originally allocated to the concessionaire and represent an open-ended financial liability. Furthermore, it should be noted that the proposed tariff level and the essential elements of risk allocation are important, if not decisive, factors in the selection of the concessionaire. An excessively generous recourse to renegotiation of the project may lead to unrealistically low proposals being submitted during the selection procedure in the expectation of tariff increases once the project has been awarded. Thus, the contracting authority may have an interest in establishing reasonable limits for statutory or contractual provisions authorizing revisions of the project agreement following changes in economic conditions.

129. It may be desirable to provide in the project agreement that a change in circumstances that justifies a revision of the project agreement must have been beyond the control of the concessionaire and of such a nature that the concessionaire could not reasonably be expected to have taken it into account at the time the project agreement was negotiated or to have avoided or overcome its consequences. For example, a tollroad operator holding an exclusive concession might not be expected to take into account and assume the risk of traffic shortfalls brought about by the subsequent opening of an alternative toll-free road by an entity other than the contracting authority. However, the concessionaire would normally be expected to take into account the possibility of reasonable labour cost increases over the life of the project. Thus, under normal circumstances, the fact that wages turned out to be higher than expected would not be sufficient reason for revising the project agreement.

130. It may also be desirable to provide in the project agreement that a request for revision of the project agreement requires that the alleged changes of economic and financial conditions amount to a certain minimum value in proportion to the total project cost or the concessionaire's revenue. Such a rule might be useful in order to avoid cumbersome adjustment negotiations for small changes until the changes have accumulated to comprise a significant figure. In some countries, there are rules that establish a ceiling for the cumulative amount of periodic revisions of the project agreement. The purpose of such rules is to avoid the misuse of the change mechanism as a means for achieving an overall financial balance that bears no relation to the one contemplated in the original project agreement. From the perspective of the concessionaire and the lenders, however, such limitations may represent exposure to considerable risk in the event, for instance, of dramatic cost increases resulting from an extraordinarily radical change of circumstances. Therefore, both the desirability of introducing a ceiling and the appropriate amount of such ceiling need to be carefully considered.

5. Exemption provisions

131. During the life of an infrastructure project, events may occur that impede the performance by a party of its contractual obligations. The events causing such an impediment are typically outside either party's control and may be of a physical nature, such as a natural disaster, or may be the result of human action, such as war, riots or terrorist attacks. Many legal systems generally recognize that a party that fails to perform a contractual obligation because of the occurrence of certain types of events may be exempted from the consequences of any such failure to perform.

(a) Definition of exempting impediments

132. Exempting impediments typically include occurrences beyond the control of a party that cause the party to be unable to perform its obligation and that the party has been unable to overcome by the exercise of due diligence. Common examples include the following: natural disasters (such as cyclones, floods, droughts, earthquakes, storms, fires or lightning); war (whether declared or not) or other military activity, including riots and civil disturbance; failure or sabotage of facilities, acts of terrorism, criminal damage or the threat of such acts; radioactive or chemical contamination or ionizing radiation; effects of the natural elements, including geological conditions that cannot be foreseen and resisted; and employees' strikes of exceptional importance.

133. Some laws make only a general reference to exempting impediments, whereas other laws contain extensive lists of circumstances that excuse the parties from performance under the project agreement. The latter technique may serve the purpose of ensuring a consistent treatment of the matter for all projects developed under the relevant legislation, thus avoiding situations where one concessionaire obtains a more favourable allocation of risks than that provided in other project agreements. However, it is important to consider the possible disadvantages of setting forth in statutory or regulatory provisions a list of events that are to be considered exempting impediments for all cases. There is a risk that the list might be incomplete, leaving out important impediments. Furthermore, certain natural disasters, such as storms, cyclones and floods, may be normal conditions at a particular time of the year at the project site. As such, those natural disasters may represent risks that any public service provider acting in the region would be expected to assume.

134. Another aspect that may need to be carefully considered is whether and to what extent certain acts of public authorities other than the contracting authority may constitute exempting impediments. The concessionaire may be required to secure a licence or other official approval for the performance of certain of its obligations. The project agreement might thus provide that, if the licence or approval is refused, or if it is granted but later withdrawn because of the concessionaire's own failure to meet the relevant criteria for the issuance of the licence or approval, the concessionaire cannot rely on the refusal as an exempting impediment. However, if the licence or approval is refused or withdrawn for extraneous or improper motives, it would be equitable to provide that the concessionaire may rely on the refusal as an exempting impediment. A further possibility of impediment might be an interruption of the project brought about by a public authority or organ of government other than the contracting authority, for instance, because of changes in governmental plans and policies that require the interruption or major revision of the project that substantially affect the original design. In such situations, it may be important to consider the institutional relationship between the contracting authority and the public authority that brings about the impediment as well as their degree of independence from one another. An event classified as an exempting impediment may in some cases amount to an outright breach of the project agreement by the contracting authority, depending on whether the contracting authority could reasonably control or influence the acts of the other public authority.

(b) Consequences for the parties

135. During the construction phase, the occurrence of exempting impediments usually justifies an extension of the time allowed for the completion of the facility. In that connection, it is important to consider the implications of any such extension for the overall duration of the project, in particular where the construction phase is taken into account for calculating the total concession period. Delays in the completion of the facility reduce the operational period and may adversely affect the global revenue estimates of the concessionaire and the lenders. It may therefore be advisable to consider under what circumstances it may be justified to extend the concession period so as to take into account possible extensions that occur during the construction phase. Lastly, it is advisable to provide that, if the event in question is of a permanent nature, the parties may have the option to terminate the project agreement (see also chap. V, "Duration, extension and termination of the project agreement", ___).

136. Another important question is whether the concessionaire will be entitled to compensation for loss of revenue or property damage that results from the occurrence of exempting impediments. The answer to that question is given by the risk allocation provided in the project agreement. Except for cases in which the Government provides some form of direct support, privately financed infrastructure projects are typically undertaken at the concessionaire's own risk, including the risk of losses that may result from natural disasters and other exempting impediments, against which the concessionaire is usually required to procure adequate insurance coverage. Thus, some laws expressly exclude any form of compensation to the concessionaire in the event of loss or damage that results from the occurrence of exempting impediments. It does not necessarily follow, however, that an event qualified as an exempting impediment may not, at the same time, justify a revision of the terms of the project agreement so as to restore its economic and financial balance (see also paras. 126-130).

137. However, a different type of risk allocation is sometimes contemplated for projects involving the construction of facilities that are permanently owned by the contracting authority or facilities that are required to be transferred to the contracting authority at the end of the project period. In some countries, the contracting authority is authorized to make arrangements for assisting the concessionaire to repair or rebuild infrastructure facilities damaged by natural disasters or similar occurrences defined in the project agreement, provided that the possibility of such assistance was contemplated in the request for proposals. Sometimes the contracting authority is authorized to agree to pay compensation to the concessionaire in case of an interruption of the work for more than a certain number of days up to a maximum time limit, if the interruption is caused by an event for which the concessionaire is not responsible.

138. Should the concessionaire become unable to perform because of any such impediment and should the parties fail to achieve an acceptable revision of the contract, some national laws authorize the concessionaire to terminate the project agreement, without prejudice to the compensation that might be due under the circumstances (see chap. V, "Duration, extension and termination of the project agreement", ___).

139. Statutory and contractual provisions on exempting impediments also need to be considered in the light of other rules governing the provision of the service concerned. The law in some legal systems requires public service providers to make every effort to continue providing the service despite the occurrence of circumstances defined as contractual impediments (see paras. 86 and 87). In those cases, it is advisable to consider the extent to which such an obligation may reasonably be imposed on the concessionaire and what compensation may be due for the additional costs and hardship faced by it.

6. Events of default and remedies

140. Generally, there is a wide range of remedies that the parties may agree on to deal with the consequences of default, culminating with termination. The following paragraphs discuss general considerations on events of default and remedies by either party (see paras. 141 and 142). They consider the legislative implication of certain types of remedies intended to rectify the causes of default and preserve the continuity of the project, in particular the intervention of the contracting authority (see paras. 143-146) or the substitution of the concessionaire (see paras. 147-150). The ultimate remedy of terminating the project agreement and the consequences that may result from termination are discussed elsewhere in the *Guide* (see chap. V, "Duration, extension and termination of the project agreement", ___).

(a) General considerations on failures to perform and remedies

141. The remedies for default by the concessionaire typically include those which are customary in construction or long-term service contracts such as forfeiture of guarantees, contractual penalties and liquidated damages.[3] In most cases, such remedies are typically contractual in nature and do not give rise to significant legislative considerations. Nevertheless, it is important to establish adequate procedures for ascertaining failures and giving opportunity for rectifying such failures. In some countries, the imposition of contractual penalties requires findings of official inspections and other procedural steps, including review by senior officials of the contracting authority prior to the imposition of more serious sanctions. Those procedures may be complemented by provisions distinguishing between defects that can be rectified and those which cannot, and setting down the corresponding procedures and remedies. It is usually advisable to require that the concessionaire be given notice requiring it to remedy the breach within a sufficient period. It may also be advisable to contemplate the payment of penalties or liquidated damages by the concessionaire in the event of non-performance of essential obligations and to clarify that no penalties apply in case of breach of secondary or ancillary obligations and for which other remedies may be obtained under national law. Furthermore, a performance monitoring system that provides for penalties or liquidated damages may be complemented by a scheme of bonuses payable to the concessionaire for improving over agreed terms.

142. While the contracting authority may protect itself against the consequences of default by the concessionaire through a variety of judicially enforceable contractual arrangements, the remedies available to the concessionaire may be subject to a number of limitations under the applicable law. Important limitations may derive from rules of law that recognize the immunity of public authorities from judicial suit and enforcement measures. Depending on the legal nature of the contracting authority or of other public authorities that assume obligations vis-à-vis the concessionaire, the latter may be deprived of the possibility of enforcing measures of execution to secure the fulfilment of obligations entered into by those public entities (see also chap. VI, "Settlement of disputes", ___). This situation makes it the more important to provide mechanisms to protect the concessionaire against the consequences of default by the contracting authority, for example by means of governmental guarantees covering specific events of default or guarantees provided by third parties, such as multilateral lending institutions (see also chap. II, "Project risks and government support", paras. 61-71).

(b) Step-in rights for the contracting authority

143. Some national laws expressly authorize the contracting authority to take over temporarily the operation of the facility, normally in case of failure to perform by the concessionaire, in particular where the contracting authority has a statutory duty to ensure the effective delivery at all times of the service concerned. In some legal systems, such a prerogative is considered to be inherent in most government contracts and may be presumed to exist even without being expressly mentioned in legislation or in the project agreement.

144. It should be noted that the contracting authority's right to intervene, its "step-in right", is an extreme measure. Private investors may fear that the contracting authority may use it, or threaten to use it, in order to impose its own desires about the way in which the service is provided, or even to get control of the project assets. It is therefore advisable to define as clearly as possible the circumstances in which step-in rights can be exercised. It is important to

[3]For a discussion of remedies used in construction contracts for complex industrial works, see the *UNCITRAL Legal Guide on Drawing Up Contracts for the Construction of Industrial Works*, chap. XVIII, "Delay, defects and other failures to perform".

limit the contracting authority's right to intervene to cases of serious failure of services and not merely in case of dissatisfaction with the concessionaire's performance. It may be useful to clarify in the law that the contracting authority's intervention in the project is temporary and is intended to remedy a specific, urgent problem that the concessionaire has failed to remedy. The concessionaire should resume responsibility for service delivery once the emergency situation has been remedied.

145. The contracting authority's ability to step in may be limited in that it may be difficult immediately to identify and engage a subcontractor to carry out the actions that the contracting authority is stepping in to do. Furthermore, frequent interventions carry a risk of the reversion to the contracting authority of risks that have been transferred in the project agreement to the concessionaire. The concessionaire should not rely on the contracting authority to step in to deal with a particular risk instead of handling it itself, as required by the project agreement.

146. It is advisable to clarify in the project agreement which party bears the cost of an intervention by the contracting authority. In most cases, the concessionaire should bear the costs incurred by the contracting authority when the intervention is caused by a performance failure attributable to the concessionaire's own fault. In some cases, to prevent disputes about liability and about the appropriate level of costs, the agreement may authorize the contracting authority to take steps to remedy the problem itself and then charge the actual cost of having done so (including its own administrative costs) to the concessionaire. However, when such intervention takes place following the occurrence of an exempting impediment (see paras. 131-139), the parties might agree on a different solution, depending on how that particular risk has been allocated in the project agreement.

(c) Step-in rights for the lenders and compulsory transfer of the concession

147. During the life of the project situations may arise where, because of default by the concessionaire or the occurrence of an extraordinary event outside the concessionaire's control, it may nevertheless be in the interest of the parties to avert termination of the project (see chap. V, "Duration, extension and termination of the project agreement", ___) by allowing the project to continue under the responsibility of a different concessionaire. The lenders, whose main security is the revenue generated by the project, are particularly concerned about the risk of interruption or termination of the project prior to repayment of the loans. In the event of default of or an impediment affecting the concessionaire, the lenders will be interested in ensuring that the work will not be left incomplete and that the concession will be operated profitably. The contracting authority, too, may be interested in allowing the project to be carried out by a new concessionaire, as an alternative for having to take it over and continue it under its own responsibility.

148. Clauses allowing the lenders to select, with the consent of the contracting authority, a new concessionaire to perform under the existing project agreement have been included in a number of recent agreements for large infrastructure projects. Such clauses are typically supplemented by a direct agreement between the contracting authority and the lenders who are providing finance to the concessionaire. The main purpose of such a direct agreement is to allow the lenders to avert termination by the contracting authority when the concessionaire is in default by substituting a concessionaire that will continue to perform under the project agreement in place of the concessionaire in default. Unlike the contracting authority's right to intervene, which relates to a specific, temporary and urgent failure of the service, lenders' step-in rights are for cases where the concessionaire's failure to provide the service is recurrent or can reasonably be regarded as irremediable. In the experience of countries that have recently made use of such direct agreements, it has been found that the ability to head off termination and provide an alternative concessionaire gives the lenders additional security against default by the concessionaire. At the same time, it provides the contracting authority an opportunity to avoid the disruption entailed by terminating the project agreement, thus maintaining continuity of service.

149. However, in some countries, the implementation of such clauses may face difficulties in the absence of legislative authorization. The concessionaire's inability to carry out its obligations is usually a ground for the contracting authority to take over the operation of the facility or terminate the agreement (see chap. V, "Duration, extension and termination of the project agreement", ___). For the purpose of selecting a new concessionaire to succeed the defaulting one, the contracting authority often needs to follow the same procedures that applied to the selection of the original concessionaire and it might not be possible for the contracting authority to agree in consultation with the lenders on engaging a new concessionaire that has not been selected pursuant to those procedures. On the other hand, even where the contracting authority is authorized to negotiate with a new concessionaire under emergency conditions, a new project agreement might need to be entered into with the new concessionaire and there may be limitations to its ability to assume the obligations of its predecessor.

150. Therefore, it may be useful to acknowledge in the law the contracting authority's right to enter into agreements with the lenders providing for the appointment, with the consent of the contracting authority, of a new concessionaire to perform under the existing project agreement, when the concessionaire seriously fails to deliver the service required under the project agreement or following the occurrence of other specified events that could justify the termination of the project agreement. The agreement between the contracting authority and the lenders should, inter alia, specify the following: the circumstances in which the lenders are permitted to substitute a new concessionaire; the procedures for the substitution of the concessionaire; the grounds for refusal by the contracting authority of a proposed substitute; and the obligations of the lenders to maintain the service at the same standards and on the same terms as required by the project agreement.

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Chapter V. Duration, extension and termination of the project agreement

CONTENTS

LEGISLATIVE RECOMMENDATIONS

For host countries wishing to promote privately financed infrastructure projects it is recommended that the following principles should be implemented by the law:

Duration and extension of the project agreement (see paras. 2-8)

Recommendation 60. The duration of the concession should be specified in the project agreement.

Recommendation 61. The term of the concession should not be extended, except in those circumstances specified in the law, such as:

(a) Completion delay or interruption of operation due to the occurrence of circumstances beyond either party's reasonable control;

(b) Project suspension brought about by acts of the contracting authority or other public authorities;

(c) To allow the concessionaire to recover additional costs arising from requirements of the contracting authority not originally foreseen in the project agreement that the concessionaire would not be able to recover during the normal term of the project agreement.

Termination of the project agreement (see paras. 9-35)

Termination by the contracting authority

Recommendation 62. The contracting authority should have the right to terminate the project agreement:

(a) In the event that it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations, owing to insolvency, serious breach or otherwise;

(b) For reasons of public interest, subject to payment of compensation to the concessionaire.

Termination by the concessionaire

Recommendation 63. The concessionaire should have the right to terminate the project agreement under exceptional circumstances specified in the law, such as:

(a) In the event of serious breach by the contracting authority or other public authority as regards the fulfilment of their obligations under the project agreement;

(b) In the event that the concessionaire's performance is rendered substantially more onerous as a result of variation orders or other acts of the contracting authority, unforeseen changes in conditions or acts of other public authorities and that the parties have failed to agree on an appropriate revision of the project agreement.

Termination by either party

Recommendation 64. Either party should have the right to terminate the project agreement in the event that the performance of its obligations is rendered impossible by the occurrence of circumstances beyond either party's reasonable control. The parties should also have the right to terminate the project agreement by mutual consent.

Consequences of expiry or termination of the project agreement (see paras. 36-62)

Transfer of assets to the contracting authority or to a new concessionaire

Recommendation 65. The project agreement should lay down the criteria for establishing, as appropriate, the compensation to which the concessionaire may be entitled in respect of assets transferred to the contracting authority or to a new concessionaire or purchased by the contracting authority upon expiry or termination of the project agreement.

Financial arrangements upon termination

Recommendation 66. The project agreement should stipulate how compensation due to either party in the event of termination of the project agreement is to be calculated, providing, where appropriate, for compensation for the fair value of works performed under the project agreement and for losses, including lost profits.

Wind-up and transfer measures

Recommendation 67. The project agreement should set out, as appropriate, the rights and obligations of the parties with respect to:

(a) The transfer of technology required for the operation of the facility;

(b) The training of the contracting authority's personnel or of a successor concessionaire in the operation and maintenance of the facility;

(c) The provision, by the concessionaire, of operation and maintenance services and the supply of spare parts, if required, for a reasonable period after the transfer of the facility to the contracting authority or to a successor concessionaire.

NOTES ON THE LEGISLATIVE RECOMMENDATIONS

A. GENERAL REMARKS

1. Most privately financed infrastructure projects are undertaken for a certain period, at the end of which the concessionaire transfers to the contracting authority the responsibility for the operation of the infrastructure facility. Section B deals with elements to be taken into account when establishing the concession period. Section C deals with the question of whether and under what circumstances the project agreement may be extended. Section D considers circumstances that may authorize the termination of the project agreement prior to the expiry of its term. Lastly, section E deals with the consequences of the expiry or termination of the project agreement, including the transfer of project assets and the compensation to which either party may be entitled upon termination, and the wind-up of the project.

B. DURATION OF THE PROJECT AGREEMENT

2. The laws of some countries contain provisions that limit the duration of infrastructure concessions to a certain number of years. Some laws establish a general limit for most infrastructure projects and special limits for projects in particular infrastructure sectors. In some countries there are maximum duration periods only for certain infrastructure sectors.

3. The desirable duration of a project agreement may depend on a number of factors, such as the operational life of the facility; the period during which the service is likely to be required; the expected useful life of the assets associated with the project; how changeable the technology required for the project is; and the time needed for the concessionaire to repay its debts and amortize the initial investment. The notion of economic "amortization", in this context, refers to the gradual charging of the investment made against project revenue on the assumption that the facility would have no residual value at the end of the project term. Given the difficulty of establishing a single statutory limit for the duration of infrastructure projects, it is advisable to provide the contracting authority with some flexibility to negotiate, in each case, a term that is appropriate to the project in question.

4. In some legal systems, this result is achieved by provisions that require that all concessions should be subject to a maximum duration period, without specifying any number of years. Sometimes the law only indicates which elements are to be taken into account for determining the duration of the concession, which may include the nature and amount of investment required to be made by the concessionaire and the normal amortization period for the particular facilities and installations concerned. Some project- or sector-specific laws provide for a combined system requiring that the project agreement should provide for the expiry of the concession at the end of a certain period or once the debts of the concessionaire have been fully repaid and a certain revenue, production or usage level has been achieved, whichever is the earliest.

5. However, where it is found necessary to adopt statutory limits, the maximum period should be sufficiently long to allow the concessionaire to repay its debts fully and to achieve a reasonable profit. Furthermore, it may be useful to authorize the contracting authority, in exceptional cases, to agree to longer concession periods, taking into account the amount of the investment and the required recovering period, and subject to special approval procedures.

C. EXTENSION OF THE PROJECT AGREEMENT

6. In the contracting practice of some countries, the contracting authority and the concessionaire may agree on one or more extensions of the concession period. More often, however, domestic laws only authorize an extension of the project agreement under exceptional circumstances. In this case, upon expiry of the project agreement the contracting authority is normally required to select a new concessionaire, normally using the same procedures applied to select

the concessionaire whose concession has expired (for a discussion of selection procedures, see chap. III, "Selection of the concessionaire").

7. A number of countries have found it useful to require that exclusive concessions be rebid from time to time rather than freely extended by the parties. Periodic rebidding may give the concessionaire strong performance incentives. The period between the initial award and the first (and subsequent) rebidding should take into account the level of investment and other risks faced by the concessionaire. For example, for solid waste collection concessions not requiring heavy fixed investments, the periodicity may be relatively short (three to five years, for example), whereas longer periods may be desirable for power or water distribution concessions. In most countries, rebidding coincides with the end of the project term, but in others a concession may be granted for a long period (say 99 years), with periodic rebidding (for instance, every 10 or 15 years). In the latter mechanism, which has been adopted in a few countries, the first rebidding occurs before the concessionaire has fully recouped its investments. As an incentive to the incumbent operator, some laws provide that the concessionaire may be given preference over other bidders in the award of subsequent concessions for the same activity. However, the concessionaire may have rights to compensation if it does not win the next bidding round, in which case all or part of the bidding proceeds may revert to the incumbent concessionaire. Requiring that the winning bidder should pay off the incumbent concessionaire for any property rights and for the investment not yet recovered reduces the longer-term risk faced by investors and lenders and provides them a valuable exit option (see paras. 39 and 40).

8. Notwithstanding the above, it is advisable not to exclude entirely the option to negotiate an extension of the concession period under certain specified circumstances. The duration of an infrastructure project is one of the main factors taken into account in the negotiation of financial arrangements and has a direct impact on the price of the services provided by the concessionaire. The parties may find that an extension of the project agreement (as a substitute for or combined with other compensation mechanisms) may be a useful option to deal with unexpected impediments or other changes of circumstances arising during the life of the project. Such circumstances may include any of the following: extension to compensate for project suspension or loss of profit due to the occurrence of impeding events (see chap. IV, "Construction and operation of infrastructure", paras. 131-139); extension to compensate for project suspension brought about by the contracting authority or other public authorities (see chap. IV, "Construction and operation of infrastructure", paras. 140 and 141); or extension to allow the concessionaire to recover the cost of additional work required to be done on the facility and which the concessionaire would not be able to recover during the normal term of the project agreement without unreasonable tariff increases (see chap. IV, "Construction and operation of infrastructure", paras. 73-76). For purposes of transparency and accountability, in some countries the extension of the concession period is subject to a global cumulative limit or requires the approval of a specially designated public authority.

D. TERMINATION

9. The grounds for termination of the project agreement before the expiry of its term and the consequences of any such termination are often dealt with in domestic legislation. Usually the law authorizes the parties to terminate the project agreement following the occurrence of certain types of events. The main interest of all parties involved in a privately financed infrastructure project is to ensure the satisfactory completion of the facility and the continuous and orderly provision of the relevant public service. Given the serious consequences of termination, as provision of the service may be interrupted or even discontinued, termination should under most circumstances be regarded as a measure of last resort. The conditions for the exercise of this right by either party should be carefully considered. While they may not need to be identical, it is generally desirable to achieve a broadly equitable balance of rights and conditions regarding termination for both parties.

10. In addition to identifying the circumstances or types of events that may give rise to a termination right, it is advisable for the parties to consider appropriate procedures to establish whether there are valid grounds for terminating the project agreement. Of particular importance is the question whether the project agreement may be unilaterally terminated or whether termination requires a decision by a judicial or other dispute settlement body.

11. The concessionaire is usually not allowed to terminate the project agreement without cause and in some legal systems termination by the concessionaire even in the event of breach by the contracting authority requires a final judicial decision. However, in some countries, pursuant to rules applicable to contracts with government entities, such a right may be exercised by public authorities, subject to payment of compensation to the concessionaire. In other countries, however, an exception is made in the case of public service concessions, whose contractual nature is found to be incompatible with unilateral termination rights. Lastly, some legal systems do not recognize unilateral termination rights for public authorities. However, project promoters and lenders would be concerned about the risk of premature or unjustified termination by the contracting authority, even where a decision to terminate might be subject to review through the dispute settlement mechanism. It should also be noted that giving the contracting authority the unilateral right to terminate the project agreement would not be an adequate substitute for well-designed contractual mechanisms of performance monitoring or for appropriate guarantees of performance (see chap. IV, "Construction and operation of infrastructure", paras. 80-97 and 108-120).

12. Provisions concerning termination should therefore be brought into line with the remedies for breach provided in the project agreement. In particular, it is useful to distinguish the conditions for termination from those for step-in by the contracting authority (see chap. IV, "Construction and operation of infrastructure", paras. 143-146). It is also important to consider the contracting authority's termination rights against the background of the financing agreements negotiated by the concessionaire with its lenders. In

most cases, events that may lead to the termination of the project agreement would also constitute events of default under the loan agreements, with the consequence that the entire outstanding debt of the concessionaire may fall due immediately. It would thus be useful to attempt to avoid the risk of termination by allowing the lenders to propose another concessionaire when termination of the project agreement with the original concessionaire appears imminent (see chap. IV, "Construction and operation of infrastructure", paras. 108-120).

13. In the light of the above, it is generally advisable to provide that the termination of the project agreement in most cases require a final finding by the dispute settlement body provided in the agreement. Such a requirement would reduce concerns about premature or unjustified recourse to termination. At the same time, it would not preclude the taking of appropriate measures to ensure the continuity of the service, pending the final decision of the dispute settlement body, as long as contractual remedies for breach, such as step-in rights for the contracting authority and the lenders, are provided in the project agreement. In countries where such a requirement would not be consistent with general principles of administrative law applicable to government contracts, it might be important to ensure, at least, that the contracting authority's right to terminate the project agreement should be without prejudice to the concessionaire's right to seek subsequent judicial review of the contracting authority's decision to terminate.

1. Termination by the contracting authority

14. The contracting authority's termination rights usually relate to three categories of circumstances: serious breach by the concessionaire; insolvency or bankruptcy of the concessionaire; and termination for reasons of public interest.

(a) Serious breach by the concessionaire

15. The contracting authority has the duty to ensure that public services are provided in accordance with applicable laws, regulations and contractual provisions. Thus, a number of domestic laws expressly recognize the contracting authority's right to terminate the project agreement in the event of breach by the concessionaire. Because of the disruptive effects of termination and in the interest of preserving the continuity of the service, it is not advisable to regard termination as a sanction for each and any instance of unsatisfactory performance by the concessionaire. On the contrary, it is generally advisable to resort to the extreme remedy of termination only in cases of "particularly serious" or "repeated" failures to perform, especially when it can no longer be reasonably expected that the concessionaire will be able or willing to perform under the project agreement. Many legal systems use specific technical expressions to refer to situations where the degree of breach by one contracting party is of such a nature that the other party may terminate their contractual relation before the expiry of its term (for example, "fundamental breach", "material breach" or similar expressions). Such situations are referred to in the *Guide* as "serious breach".

16. Circumscribing the possibility of termination to cases of serious breach may give assurance to lenders and project promoters that they will be protected against unreasonable or premature decisions by the contracting authority. The law may generally provide for the contracting authority's right to terminate the project agreement upon serious breach by the concessionaire and leave it for the project agreement to define further the notion of serious breach and, as appropriate, provide illustrative examples of it. From a practical point of view, it is not advisable to attempt, by statute or in the project agreement, to provide a list of the events that justify termination.

17. As a general rule, it is desirable that the concessionaire be granted an additional period of time to fulfil its obligations and to avert the consequences of its breach prior to the contracting authority's resorting to remedies. For example, the concessionaire should be given notice specifying the nature of the relevant circumstances and requiring it to rectify them within a certain period. The possibility might also be given for the lenders and sureties, as the case may be, to avert the consequences of the concessionaire's breach, for instance by temporarily engaging a third party to cure the consequences of breach by the concessionaire, in accordance with the terms of the performance bonds provided to the contracting authority or the terms of a direct agreement between the lenders and the contracting authority (see chap. IV, "Construction and operation of infrastructure", paras. 108-120 and 147-150). The project agreement may also provide that, if the circumstances are not rectified before the expiry of the relevant period, the contracting authority may then terminate the project agreement, subject to first notifying the lenders and giving them an opportunity within a certain period to exercise any right of substitution that the lenders might have in accordance with a direct agreement between them and the contracting authority. However, reasonable deadlines need to be set, since the contracting authority cannot be expected to bear indefinitely the continuing cost of a situation of breach of the project agreement by the concessionaire. Furthermore, the procedures should be without prejudice to the contracting authority's right to step in to avert the risk of disruption of service by the concessionaire (see chap. IV, "Construction and operation of infrastructure", paras. 145 and 146).

(i) Serious breach before the beginning of construction

18. The concessionaire typically needs to accomplish a series of steps prior to undertaking construction works. Some of these requirements may even constitute conditions precedent to the entry into force of the project agreement. Examples of events that often justify the withdrawal of the concession award at an early stage include the following:

(a) Failure to secure the required financial means, to sign the project agreement or to establish the project company within the established deadline;

(b) Failure to obtain licences or permits required for pursuing the activity that is the object of the concession;

(c) Failure to undertake the construction of the facility, to commence development of the project or to submit the

plans and designs required within a set period of time from the award of the concession.

19. Termination should in principle be reserved for situations where the contracting authority may no longer reasonably expect that the selected concessionaire will take the necessary measures to commence execution of the project. In that connection, it is important for the contracting authority to take into account any circumstances that may excuse the concessionaire's delay in fulfilling its obligations. Furthermore, the concessionaire should not suffer the consequences of inaction or error on the part of the contracting authority or other public authorities. For instance, the termination of the project agreement would not normally be justified if the concessionaire's failure to obtain government licences and permits within the agreed schedule was not attributable to the concessionaire's own fault.

(ii) Serious breach during the construction phase

20. Examples of events that may justify the termination of the project agreement during the construction phase include the following:

(a) Failure to observe building regulations, specifications or minimum design and performance standards and non-excusable failure to complete work within the agreed schedule;

(b) Failure to provide or renew the required guarantees in the agreed terms;

(c) Violation of essential statutory or contractual obligations.

21. Termination should be commensurate with the degree of breach by the concessionaire and the consequences of breach for the contracting authority. For instance, the contracting authority may have a legitimate interest in specifying a date when the construction must be completed and may therefore be justified in regarding a delay in completion as an event of breach and hence a ground for termination. However, delay alone, in particular if it is not excessive in relation to the specifications of the project agreement, might not be sufficient reason for termination when the contracting authority is otherwise satisfied of the concessionaire's ability to complete the construction in accordance with the required quality standards and its commitment to doing so.

(iii) Serious breach during the operational phase

22. Examples of particular instances of breach that typically justify the termination of the concession during the operational phase include any of the following:

(a) Serious failure to provide services in accordance with the statutory and contractual standards of quality, including disregard of price control measures;

(b) Non-excusable suspension or interruption of the provision of the service without prior consent from the contracting authority;

(c) Serious failure by the concessionaire to maintain the facility, its equipment and appurtenances in accordance with the agreed standards of quality or non-excusable delay in carrying out maintenance works in accordance with the agreed plans, schedules and timetables;

(d) Failure to comply with sanctions imposed by the contracting authority or the regulatory agency, as appropriate, for infringements of the concessionaire's duties.

23. For the purpose of enhancing transparency and integrity in governmental matters, the laws of some countries also provide for the termination of project agreements if the concessionaire is guilty of tax fraud or other types of fraudulent acts, or if its agents or employees are involved in bribery of public officials and other corrupt practices (see also chap. VII, "Other relevant areas of law", paras. 50-52). The later considerations underscore the importance of designing effective mechanisms to combat corruption and bribery and to afford the concessionaire the opportunity to file complaints against demands for illegal payments or unlawful threats by officials of the host country.

(b) Insolvency of the concessionaire

24. Infrastructure services typically need to be provided continuously and for that reason most domestic laws stipulate that the agreement may be terminated if the concessionaire is declared insolvent or bankrupt. In order to ensure the continuity of the service, the assets and property required to be handed over to the contracting authority may be excluded from the insolvency proceedings and the law may require prior governmental approval for any act of disposition by a liquidator or insolvency administrator of any categories of assets owned by the concessionaire.

25. In legal systems that allow the establishment of security interests over the concession itself (see chap. IV, "Construction and operation of infrastructure", para. 57), the law usually provides that the contracting authority may, in consultation with the secured creditors, appoint a temporary administrator so as to ensure the continued provision of the relevant service, until the secured creditors admitted to the insolvency proceedings decide, upon the recommendation of the insolvency administrator, whether the activity should be pursued or whether the right to exploit the concession should be put to a bidding process.

(c) Termination for reasons of public interest

26. In the contracting practice of some countries, public authorities procuring construction works traditionally retain the right to terminate the construction contract for reasons of public interest (that is, without having to provide any justification other than that the termination is in the Government's interest). In some common law jurisdictions, that right, which is sometimes referred to as "termination for convenience", can only be exercised if expressly provided for in a statute or in the relevant contract. Several legal systems belonging to the civil law tradition also recognize a similar power of public authorities to terminate contracts

for reasons of public interest or "general interest". In some countries, such a right may be implied in the Government's contracting power, even in the absence of an explicit statutory or contractual provision to that effect. The Government's right to terminate for reasons of public interest, in those legal systems which recognize it, is regarded as essential in order to preserve the Government's unfettered ability to exercise its functions affecting the public good.

27. Nevertheless, the conditions for the exercise of this right, and the consequences of doing so, should be carefully considered. The authority to determine what constitutes public interest may lie within the Government's discretion, so that the contracting authority's decision to terminate the project agreement could only be challenged under specific circumstances (for instance, improper motive, "*détournement de pouvoir*"). However, a general and unqualified right to terminate the project agreement for reasons of public interest may represent an imponderable risk that neither the concessionaire nor the lenders may be ready to accept without sufficient guarantees that they will receive prompt compensation for the loss sustained. The possibility of termination for reasons of public interest, where contemplated, should therefore be made known to prospective investors on the earliest possible occasion and should be expressly mentioned in the draft project agreement circulated with the request for proposals (see chap. III, "Selection of the concessionaire", para. 67). The compensation due for termination for reasons of public interest may, in practice, cover items that are taken into account when calculating the compensation that is due for termination for serious breach by the contracting authority (see para. 42). Furthermore, it is generally advisable to limit the exercise of the right to terminate the project agreement to situations where such termination is needed for a compelling reason of public interest, which should be restrictively interpreted (for example, where major subsequent changes in governmental plans and policies require the integration of a project into a larger network or where changes in the contracting authority's plans require major project revisions that substantially affect the original design or the project's commercial feasibility under private operation). In particular, it is not advisable to regard the right of termination for reasons of public interest as a substitute for other contractual remedies in case of dissatisfaction with the concessionaire's performance (see chap. IV, "Construction and operation of infrastructure", paras. 140-150).

2. Termination by the concessionaire

28. While the contracting authority in some legal systems may retain an unqualified right to terminate the project agreement, the grounds for termination by the concessionaire are usually limited to serious breach by the contracting authority or other exceptional situations and do not normally include a general right to terminate the project agreement at will. Moreover, some legal systems do not recognize the concessionaire's right to terminate the project agreement unilaterally, but only the right to request a third party, such as the competent court, to declare the termination of the project agreement.

(a) Serious breach by the contracting authority

29. Generally, the concessionaire's right to terminate the project agreement is limited to situations where the contracting authority is found to be in breach of a substantial part of its obligations (such as failure to make agreed payments to the concessionaire or failure to issue licences required for the operation of the facility for reasons other than the concessionaire's own fault). In those legal systems where the contracting authority has the right to request modifications in the project, the concessionaire may have the right to terminate the project agreement if the contracting authority alters or modifies the original project in such a fashion as to cause a substantial increase in the amount of investment required and the parties fail to agree on the appropriate amount of compensation (see chap. IV, "Construction and operation of infrastructure", paras. 73-76).

30. In addition to serious breach by the contracting authority itself, it may be equitable to authorize termination by the concessionaire should the latter be rendered unable to provide the service as a result of acts of public authorities other than the contracting authority, such as failure to provide certain measures of support required for the execution of the project agreement (see chap. II, "Project risks and government support", paras. 35-60).

31. Although termination by the concessionaire may not always require a final finding by a judicial or other dispute settlement body, there may be limits to the remedies available to the concessionaire in the event of breach by the contracting authority. Pursuant to a rule of law followed in many legal systems, a party to a contract may withhold performance of its obligations in the event of breach by the other party of a substantial part of its obligations. However, in some legal systems that rule does not apply to government contracts and the law provides instead that government contractors are not excused from performing solely on the ground of breach by the contracting authority unless and until the contract is rescinded by a judicial or arbitral decision.

32. Limitations on the concessionaire's right to withhold performance are typically intended to ensure the continuity of public services (see chap. IV, "Construction and operation of infrastructure", paras. 86 and 87). Nevertheless, it should be noted that while the contracting authority may mitigate the consequences of breach by the concessionaire by using its right to step in, the concessionaire does not usually have a comparable remedy. In the event of serious breach by the contracting authority, the concessionaire may sustain considerable or even irreparable damage, depending on the time required to obtain a final decision releasing the concessionaire from its obligations under the project agreement. These circumstances underscore the importance of government guarantees in respect of obligations assumed by contracting authorities (see chap. II, "Project risks and government support", paras. 45-50) and the need for allowing the parties the choice of expeditious and effective dispute settlement mechanisms (see chap. VI, "Settlement of disputes", paras. 3-42).

(b) Changes in conditions

33. Domestic laws often allow the concessionaire to terminate the project agreement if the concessionaire's performance has been rendered substantially more onerous by the occurrence of an unforeseen change in conditions and the parties have failed to agree on an appropriate revision to adapt the project agreement to the changed conditions (see chap. IV, "Construction and operation of infrastructure", paras. 126-130).

3. Termination by either party

(a) Impediment of performance

34. Some laws provide that the parties may terminate the project agreement if the performance of their obligations is rendered permanently impossible as a result of a circumstance defined in the project agreement as an exempting impediment (see chap. IV, "Construction and operation of infrastructure", paras. 132-139). In that connection, it is advisable to provide in the project agreement that if the exempting impediment persists for a certain period or if the cumulative duration of two or more exempting impediments exceeds a certain time, the agreement may be terminated by either party. If the execution of the project is rendered impossible on legal grounds, because of changes in legislation or as a result of judicial decisions affecting the validity of the project agreement, for instance, such a termination right might not require any period of time to elapse and might be exercised immediately upon the change of legislation or other legal obstacle becoming effective.

(b) Mutual consent

35. Some domestic laws authorize the parties to terminate the project agreement by mutual consent, usually subject to the approval of a higher authority. Legislative power to this effect may be needed by the contracting authority in legal systems where the termination by mutual consent might amount to a discontinuation of the public service for which the contracting authority is responsible.

E. CONSEQUENCES OF EXPIRY OR TERMINATION OF THE PROJECT AGREEMENT

36. The concessionaire's right to operate the facility and to provide the relevant service typically finishes upon expiry of the project term or termination of the project agreement. Unless the infrastructure is to be permanently owned by the concessionaire, the expiry or termination of the project agreement often requires the transfer of assets to the contracting authority or to another concessionaire who undertakes to operate the facility. There may be important financial consequences that will need to be regulated in detail in the project agreement, in particular in the event of termination by either party. The parties will also need to agree on various wind-up measures to ensure the orderly transfer of the responsibility for operating the facility and providing the service.

1. Transfer of project-related assets

37. In most cases, the assets and property originally made available to the concessionaire and other goods related to the project are to revert to the contracting authority upon expiry or termination of the project agreement (see chap. IV, "Construction and operation of infrastructure", paras. 23-29). In a typical "build-operate-transfer" project, the concessionaire would also be obliged to transfer to the contracting authority the physical infrastructure and other project-related assets upon expiry or termination of the project agreement. The assets required to be transferred to the contracting authority often include intangible assets, such as outstanding receivables and other rights existing at the time of transfer. Depending on the project, the assets to be transferred may include specific technology or know-how (see paras. 51-55). It should be noted that in some projects the assets are transferred directly from the concessionaire to another concessionaire who succeeds it in the provision of the service.

(a) Transfer of assets to the contracting authority

38. Different arrangements may be needed, depending on the type of asset to be transferred (see chap. IV, "Construction and operation of infrastructure", para. 28):

(a) Assets that must be transferred to the contracting authority. In the legal tradition of some countries, at the end of the project term, the concessionaire is required to transfer such assets free of any liens and encumbrances and at no cost to the contracting authority, except for compensation for improvements made to, or modernization of, the property for the purpose of ensuring the continuity of the service the cost of which has not yet been recovered by the concessionaire. In practice, such a rule presupposes the negotiation of a concession period sufficiently long and a level of revenue high enough for the concessionaire to amortize fully its investment and to repay its debts in full. Other laws allow for more flexibility by authorizing the contracting authority to compensate the concessionaire for the residual value, if any, of assets built by the concessionaire;

(b) Assets that may be purchased by the contracting authority, at its option. If the contracting authority decides to exercise its option to purchase those assets, the concessionaire is normally entitled to compensation corresponding to their fair market value at the time. However, if those assets were expected to be fully amortized (that is, if the concessionaire's financing arrangements do not envisage any expectation of residual value of the assets), then the price paid might be only nominal. In the contracting practice of some countries, it is usual for contracting authorities to be granted some security interest in such assets as a guarantee for their effective transfer;

(c) Assets that remain the private property of the concessionaire. Typically these assets may be freely removed or disposed of by the concessionaire.

(b) Transfer of assets to a new concessionaire

39. As indicated earlier, the contracting authority may wish to rebid the concession at the end of the project agreement, rather than to operate the facility itself (see para. 3). For that purpose, it may be useful for the law to require the concessionaire to make the assets available to a new concessionaire. In order to ensure an orderly transition and continuity of the service, the concessionaire should be required to cooperate with the new concessionaire in the handover. The transfer of assets between the concessionaires may require that some compensation be paid to the incumbent concessionaire, depending on whether or not the assets have been amortized.

40. One important element to consider in this connection is the structure of the financial proposal formulated by the concessionaire during the selection process (see also chap. IV, "Construction and operation of infrastructure", para. 27). In public infrastructure projects, one of the basic assumptions of the bidders' financial proposal is that all assets required to be built or acquired for the project will be fully amortized (that is, their cost will be recovered in full) in the life of the project. Thus, the financial proposals will not normally include an expectation of residual value for the assets at the end of the project period. In such cases, there may not be a prima facie reason for requiring a successor concessionaire to pay any compensation to the original concessionaire, which may be required to make all assets available to its successor at no cost or only for a nominal consideration. Indeed, if the concessionaire has achieved its expected return, a transfer payment from a successor concessionaire would be an additional cost that would ultimately have to be remunerated by the prices charged by the successor under the second agreement. However, if the tariff level contemplated in the concessionaire's original proposal was based on the assumption of some residual value of the assets at the end of the project period or if the financial proposal assumed significant revenue from third parties, the concessionaire might be entitled to compensation for assets handed over to a successor concessionaire.

(c) Condition of assets at the time of transfer

41. Where assets are handed over to the contracting authority or transferred directly to a new concessionaire upon the expiry of the concession period, the concessionaire is typically obligated to transfer them, free of liens or encumbrances, and in such condition as would be necessary for normal functioning of the infrastructure facility, taking into account the needs of the service. The contracting authority's right to receive those assets in such operating condition is complemented in some laws by the obligation imposed upon the concessionaire to keep and transfer the project in such proper condition as prudent maintenance requires and to provide some sort of guarantee to that effect (see chap. IV, "Construction and operation of infrastructure", para. 118). Where the contracting authority requires the assets to be returned in a prescribed condition, the required conditions should be reasonable. While it may be reasonable for the contracting authority to require that the assets have some defined period of residual life, it would not be reasonable to expect them to be as new. Furthermore, these requirements may not be applicable in the event of termination of the project agreement, in particular termination prior to successful completion of the construction phase.

42. It is advisable to devise procedures for ascertaining the condition of the assets that should be transferred to the contracting authority. It may be useful, for example, to establish a committee comprised of representatives of both the contracting authority and the concessionaire to establish whether the facilities are in the prescribed condition and conform to the relevant requirements set forth in the project agreement. The project agreement may also provide for the appointment and terms of reference of such a committee, which may be given authority to request reasonable measures by the concessionaire to repair or eliminate any defects and deficiencies found in the facilities. It may be advisable to provide for a special inspection to take place one year prior to the termination of the concession, following which the contracting authority may require additional maintenance measures by the concessionaire so as to ensure that the goods are in proper condition at the time of the transfer. The contracting authority may wish to require that the concessionaire provide special guarantees for the satisfactory handover of the facilities (see chap. IV, "Construction and operation of infrastructure", para. 118). The contracting authority might draw on such guarantees to pay the repair cost of damaged assets or property.

2. Financial arrangements upon termination

43. Termination of the project agreement may occur before the concessionaire has been able to recover its investment, repay its debts and yield the expected profit, which may cause significant loss to the concessionaire. Loss may also be sustained by the contracting authority, which may need to make additional investment or incur considerable expense in order, for instance, to ensure the completion of the facility or the continued provision of the relevant services. In view of these circumstances, project agreements typically contain extensive provisions dealing with the financial rights and obligations of the parties upon termination. The usual standards of compensation typically vary according to the various grounds for termination. Nevertheless, the following factors are usually taken into account in compensation arrangements:

(a) Outstanding debt, equity investment and anticipated profit. Project termination is typically included among the events of default in the concessionaire's loan agreements. Since loan agreements usually include a so-called "acceleration clause", whereby the entire debt may become due upon the occurrence of an event of default, the immediate loss sustained by the concessionaire upon termination of the project agreement may include the amount of debt then outstanding. Whether and to what extent such a loss might

be compensated for by the contracting authority usually depends on the grounds for terminating the project agreement. Partial compensation may be limited to an amount corresponding to the value of works satisfactorily performed by the concessionaire, whereas full compensation would cover the entire outstanding debt. Another category of loss that is sometimes taken into account in compensation arrangements refers to loss of equity investment by the project promoters, to the extent that such an investment has not yet been recovered at the time of termination. Lastly, termination also deprives the concessionaire of future profits that the facility may generate. Although lost profits are not usually regarded as actual damage, in exceptional circumstances, such as wrongful termination by the contracting authority, the current value of expected future profit may be included in the compensation due to the concessionaire;

(b) Degree of completion, residual value and amortization of assets. Contractual compensation schemes for various termination grounds typically include compensation commensurate with the degree of completion of the works at the time of termination. The value of the works is usually determined on the basis of the investment required for construction (in particular if the termination takes place during the construction phase), the replacement cost or the "residual" value of the facility. The residual value means the market value of the infrastructure at the time of termination. Market value may be difficult to determine or even inexistent for certain types of physical infrastructure (such as bridges or roads) or for facilities whose operational life is close to expiry. Sometimes the residual value may be estimated taking into account the expected usefulness of the facility for the contracting authority. However, difficulties may be found in establishing the value of unfinished works, in particular if the amount of the investment still required by the contracting authority to render the facility operational would exceed the amount actually invested by the concessionaire. In any event, full payment of residual value seldom takes place, in particular where the project's revenue constitutes the sole remuneration for the concessionaire's investment. Thus, instead of full compensation for the facility's value, the concessionaire often receives compensation only for the residual value of assets that have not yet been fully amortized at the time of termination.

(a) Termination due to breach by the concessionaire

44. The concessionaire is not usually entitled to damages in the event of termination due to its own breach. In some cases the concessionaire may be under an obligation to pay damages to the contracting authority, although, in practice, a defaulting concessionaire whose debts are declared due by its creditors would seldom have sufficient financial means left for actual payment of such damages.

45. It should be noted that termination due to breach, even where it is regarded as a sanction for serious performance failures, should not result in the unjust enrichment of either party. Thus, termination does not necessarily entail a right for the contracting authority to take over assets without making any payment to the concessionaire. An equitable solution for dealing with this issue may be to distinguish between the different types of asset, according to the arrangements envisaged for them in the project agreement (see para. 38):

(a) Assets that must be transferred to the contracting authority. Where the project agreement requires the automatic transfer of project assets to the contracting authority at the end of the project agreement, termination on breach does not usually entail the payment of compensation to the concessionaire for those assets, except for the residual value of work satisfactorily performed, to the extent that it has not yet been amortized by the concessionaire;

(b) Assets that may be purchased by the contracting authority, at its option. Financial compensation may be adequate in cases where the contracting authority has an option to buy the assets at market value on expiry of the project agreement or the right to require that such an option be given to the winner of a new project award. However, it may be legitimate to envisage a financial compensation that is less than the full value of the assets so as to stimulate performance by the concessionaire. By the same token, such compensation may not need to cover the full cost of repaying the concessionaire's outstanding debt. It is advisable to set forth the details of the formula for financial compensation in the project agreement (that is, whether it covers the break-up value of the asset or the lesser of the outstanding debt and the alternative use value);

(c) Assets that remain the private property of the concessionaire. Assets in the concessionaire's private property that do not fall under *(a)* or *(b)* above may usually be removed and disposed of by the concessionaire, so that the need for compensation arrangements seldom arises. However, a different situation may arise in the case of fully privatized projects, where all assets, including those essential for the provision of the services, are owned by the concessionaire. In such cases, in order to ensure the continuity of the services, the contracting authority may find it necessary to take over the assets, even though not contemplated in the project agreement. In such cases, it would be equitable to compensate the concessionaire for the fair market value of the assets. The project agreement may, however, provide that the compensation should be reduced by the costs incurred by the contracting authority in operating the facility or engaging another operator.

(b) Termination due to breach by the contracting authority

46. The concessionaire is usually entitled to full compensation for loss sustained as a result of termination on grounds attributable to the contracting authority. The compensation due to the concessionaire usually includes compensation for the value of the works and installations, to the extent they have not already been amortized, as well as for the loss caused to the concessionaire, including lost profits, which are usually calculated on the basis of the concessionaire's revenue during previous financial years, when termination occurs during the operational phase, or are based on a projection of the expected benefit during the duration originally envisaged. The concessionaire may be entitled to full compensation of debt and equity, including debt service and lost profits.

(c) Termination on other grounds

47. When considering compensation arrangements for termination due to circumstances unrelated to breach by either party, it may be useful to distinguish exempting impediments from termination declared by the contracting authority for reasons such as public interest or other similar reasons.

(i) Termination due to exempting impediments

48. By definition, exempting impediments are events beyond the parties' control and, as a general rule, termination under such circumstances might not give rise to claims for damages by either party. However, there may be circumstances where it might be equitable to provide for some compensation to the concessionaire, such as fair compensation for works already completed, in particular where, because of the specialized nature of the assets, they cannot be removed by the concessionaire or meaningfully used by it, but may be effectively used by the contracting authority for the purpose of providing the relevant service (a bridge, for instance). However, since termination in such cases cannot be attributed to the contracting authority, the compensation due to the concessionaire may not necessarily need to be "full" compensation (that is, repayment of debt, equity and lost profits).

(ii) Termination for convenience

49. Where the project agreement recognizes the contracting authority's right to terminate for its convenience, the compensation payable to the concessionaire usually covers compensation for the same items included in compensation payable upon termination for breach by the contracting authority (see para. 46), although not necessarily to the full extent. In order to establish the equitable amount of compensation due to the concessionaire, it may be useful to distinguish between termination for convenience during the construction phase and termination for convenience during the operational phase:

(a) Termination for convenience during the construction phase. If the project agreement is terminated during the construction phase, the compensation arrangements may be similar to those which are followed in connection with large construction contracts that allow for termination for convenience. In those cases, the contractor is usually entitled to the portion of the price that is attributable to the construction satisfactorily performed, as well as for expenses and losses incurred by the contractor arising from the termination. However, since the contracting authority does not normally pay a price for the construction work carried out by the concessionaire, the main criterion for calculating compensation would typically be the total investment effectively made by the concessionaire up to the time of termination, including all sums actually disbursed under the loan facilities extended by the lenders to the concessionaire for the purpose of carrying out construction under the project agreement, and expenses related to the cancellation of loan agreements. One additional question is whether and to what extent the concessionaire may be entitled to recover lost profit for the portion of the contract that has been terminated for convenience. On the one hand, the concessionaire might have foregone other business opportunities in anticipation of completing the project and operating the facility through the anticipated duration of the concession. On the other hand, an obligation of the contracting authority to compensate the concessionaire for its lost profit might make it financially prohibitive for the contracting authority to exercise its right of termination for convenience. One approach may be for the project agreement to establish a scale of payments to be made by the contracting authority as compensation for lost profits and the amount of the payments depending upon the stage of the construction that has been completed when the project agreement is terminated for convenience;

(b) Termination for convenience during the operational phase. As regards the construction work satisfactorily completed by the concessionaire, the compensation arrangements may be the same as for termination for convenience during the construction phase. However, equitable compensation for termination for convenience during the operational phase might require fair compensation for lost profits. The higher standard of compensation in this case may be justified by the fact that, unlike termination during the construction phase, when the contracting authority might need to undertake to complete the work at its own expense, upon termination during the operational phase the contracting authority might be able to receive a completed facility capable of being operated profitably. Compensation for lost profits is often calculated on the basis of the concessionaire's revenue during a certain number of previous financial years, but in some cases other elements, such as the anticipated profit on the basis of the agreed tariffs, may need to be taken into account. This is so because in some infrastructure projects such as toll roads and similar projects, which are characterized by high financial costs and relatively low income at the early stages of operation, termination may occur before the project has a history of profitability.

3. Wind-up and transitional measures

50. Where the facility is transferred to the contracting authority at the end of the concession period, the parties may need to make a series of arrangements in order to ensure that the contracting authority will be able to operate the facility at the prescribed standards of efficiency and safety. The project agreement may provide for the concessionaire's obligation to transfer certain technology or know-how required to operate the infrastructure facility. The project agreement may also provide for the continuation, for a certain transitional period, of certain obligations of the concessionaire in respect of the operation and maintenance of the facility. It may further include an obligation, on the part of the concessionaire, to supply or facilitate the supply of spare parts that may be needed by the contracting authority to carry out repairs in the facility. It should be noted, however, that the concessionaire might not be in a position to undertake itself some of the transitional measures referred to below, since in most cases the concessionaire would have been established for the sole purpose of carrying out the project and would need to procure the relevant technology or spare parts from third parties.

(a) Transfer of technology

51. In some cases, the facility transferred to the contracting authority will embody various technological processes necessary for the generation of certain goods, such as electricity or potable water, or the provision of the relevant services, such as telephone services. The contracting authority will often wish to acquire a knowledge of those processes and their application. The contracting authority will also wish to acquire the technical information and skills necessary for the operation and maintenance of the facility. Even where the contracting authority has the basic capability to undertake certain elements of the operation and maintenance (for example, building or civil engineering), the contracting authority may need to acquire a knowledge of special technical processes necessary to effect the operation in a manner appropriate to the facility in question. The communication to the contracting authority of that knowledge, information and skills is often referred to as the "transfer of technology". Obligations concerning the transfer of technology cannot be unilaterally imposed on the concessionaire and, in practice, these matters are the subject of extensive negotiations between the parties concerned. While the host country has a legitimate interest in gaining access to the technology needed to operate the facility, due account should be taken of the commercial interests and business strategies of the private investors.

52. Differing contractual arrangements can be adopted for the transfer of technology and the performance of the other obligations necessary to construct and operate the facility. The transfer of technology itself may occur in different ways, for example, through the licensing of industrial property, through the creation of a joint venture between the parties or the supply of confidential know-how. The *Guide* does not attempt to deal comprehensively with contract negotiation and drafting relating to the licensing of industrial property or the supply of know-how, as this subject has already been dealt with in detail in publications issued by other United Nations bodies.[1] The following paragraphs merely note certain major issues concerning the communication of skills necessary for the operation and maintenance of the facility through the training of the contracting authority's personnel or through documentation.

53. The most important method of conveying to the contracting authority the technical information and skills necessary for the proper operation and maintenance of the works is the training of the contracting authority's personnel. In order to enable the contracting authority to decide on its training requirements, in the request for proposals or during the contract negotiations the contracting authority might request the concessionaire to supply the contracting authority with an organizational chart showing the personnel requirements for the operation and maintenance of the works, including the basic technical and other qualifications the personnel must possess. Such a statement of requirements should be sufficiently detailed to enable the contracting authority to determine the extent of training required in relation to the personnel available to it. The concessionaire will often have the capability to provide the training. In some cases, however, the training may be given more effectively by a consulting engineer or through an institution specializing in training.

54. Technical information and skills necessary for the proper operation and maintenance of the facility may also be conveyed through the supply of technical documentation. The documentation to be supplied may consist of plans, drawings, formulas, manuals of operation and maintenance and safety instructions. It may be advisable to list in the project agreement the documents to be supplied. The concessionaire may be required to supply documents that are comprehensive and clearly drafted and are in a specified language. It may be advisable to obligate the concessionaire, at the request of the contracting authority, to give demonstrations of procedures described in the documentation if the procedures cannot be understood without demonstrations.

55. The points in time when the documentation is to be supplied may be specified. The project agreement may provide that the supply of all documentation is to be completed by the time fixed in the contract for completion of the construction. The parties may also wish to provide that transfer of the facility is not to be considered completed unless all documentation relating to the operation of the works and required under the contract to be delivered prior to the completion has been supplied. It may be advisable to provide that some documentation, such as operating manuals, is to be supplied during the course of construction, as such documentation may enable the contracting authority's personnel or engineer to obtain an understanding of the working of machinery or equipment while it is being erected.

(b) Assistance in connection with operation and maintenance of the facility after its transfer

56. The degree of assistance from the concessionaire needed by the contracting authority with regard to the supply of spare parts and services will depend on the technology and skilled personnel available to the contracting authority. If the contracting authority lacks personnel sufficiently skilled for the technical operation of the facil-

[1]The negotiation and drafting of contracts for the licensing of industrial property and the supply of know-how is dealt with in detail in World Intellectual Property Organization, *Licensing Guide for Developing Countries* (WIPO publication No. 620 *(E)*, 1977). The main issues to be considered in negotiating and drafting such contracts are set forth in the *Guidelines for Evaluation of Transfer of Technology Agreements*, Development and Transfer of Technology Series, No. 12 (ID/233, 1979), and in the *Guide for Use in Drawing Up Contracts Relating to the International Transfer of Know-How in the Engineering Industry* (United Nations publication, Sales No. E.70.II.E.15). Another relevant publication is the *Handbook on the Acquisition of Technology by Developing Countries* (United Nations publication, Sales No. E.78.II.D.15). For a discussion of transfer of technology in the context of contracts for the construction of industrial works, see the *UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works* (United Nations publication, Sales No. E.87.V.10), chap. VI, "Transfer of technology".

ity, it may wish to obtain the concessionaire's assistance in operating the facility, at least for an initial period. The contracting authority may, in some cases, wish the concessionaire to provide the personnel to occupy many of the technical posts in the facility, while in other cases the contracting authority may wish the concessionaire only to provide technical experts to collaborate in an advisory capacity with the contracting authority's personnel in the performance of a few highly specialized operations.

57. In order to assist the contracting authority in operating and maintaining the facility, the project agreement may obligate the concessionaire to submit, prior to the transfer of the facility, an operation and maintenance programme designed to keep the facility operating over its remaining lifetime at the level of efficiency required under the project agreement. An operation and maintenance programme would include matters such as an organizational chart showing the key personnel required for the technical operation of the facility and the functions to be discharged by each person; periodic inspection of the facility; lubrication, cleaning and adjustment; and replacement of defective or worn-out parts. Maintenance may also include operations of an organizational character, such as establishing a maintenance schedule or maintenance records. The concessionaire may also be required by the contracting authority to supply operation and maintenance manuals setting out appropriate operation and maintenance procedures. Those manuals should be in a format and language readily understood by the contracting authority's personnel.

58. An effective means of training the contracting authority's personnel in operation and maintenance procedures may be to provide in the project agreement that the personnel of the contracting authority are to be associated with the personnel of the concessionaire in carrying out the operation and maintenance for a certain time prior to or beyond the transfer of the facility. The positions to be occupied by the personnel employed by the contracting authority can then be identified and their qualifications and experience specified. In order to avoid friction and inefficiency, it is desirable that any authority to be exercised by the personnel of each party over the personnel of the other during the relevant period be clearly described.

(c) Supplies of spare parts

59. In projects that provide for the transfer of the facility to the contracting authority, the contracting authority will have to obtain spare parts to replace those which are worn out or damaged and to maintain, repair and operate the facility. Spare parts may not be available locally and the contracting authority may have to depend on the concessionaire to supply them. The planning of the parties with respect to the supply of spare parts and services after the transfer of the facility would be greatly facilitated if the parties were to anticipate and provide in the project agreement for the needs of the contracting authority in that regard. However, given the long duration of most infrastructure projects, it may be difficult for the parties to anticipate and provide in the project agreement for the needs of the contracting authority after the transfer of the facility.

60. A possible approach may be for the parties to enter into a separate contract regulating these matters.[2] Such a contract may be entered into closer in time to the transfer of the facility, when the contracting authority may have a clearer view of its requirements. If spare parts are manufactured not by the concessionaire but for the concessionaire by suppliers, the contracting authority may prefer to enter into contracts with those suppliers rather than to obtain them from the concessionaire or, alternatively, the contracting authority may wish to have the concessionaire procure them as the contracting authority's agent.

61. It is desirable for the contracting authority's personnel to develop the technical capacity to install the spare parts. For this purpose, the project agreement may obligate the concessionaire to supply the necessary instruction manuals, tools and equipment. The instruction manuals should be in a format and language readily understood by the contracting authority's personnel. The contract may also require the concessionaire to furnish "as built" drawings indicating how the various pieces of equipment interconnect and how access can be obtained to them to enable the spare parts to be installed and to enable maintenance and repairs to be carried out. In certain cases, it may be appropriate for the concessionaire to be required to train the contracting authority's personnel in the installation of spare parts.

(d) Repairs

62. It is in the contracting authority's interest to enter into contractual arrangements that will ensure that the facility will be repaired expeditiously in the event of a breakdown. In many cases, the concessionaire may be better qualified than a third person to effect repairs. In addition, if the project agreement prevents the contracting authority from disclosing to third persons the technology supplied by the concessionaire, this may limit the selection of third persons to effect repairs to those who provide assurances regarding non-disclosure of the concessionaire's technology that are acceptable to the concessionaire. On the other hand, if major items of equipment have been manufactured for the concessionaire by suppliers, the contracting authority may find it preferable to enter into independent contracts for repair with them. In defining the nature and duration of repair obligations imposed on the concessionaire, if any, it is advisable to do so clearly and to distinguish them from obligations assumed by the concessionaire under quality guarantees to remedy defects in the facility.

[2]The Economic Commission for Europe has prepared a *Guide on Drawing Up International Contracts for Services Relating to Maintenance, Repair and Operation of Industrial and Other Works*, which may, mutatis mutandis, assist parties in drafting a separate contract or contracts dealing with maintenance and repair of the facility after its transfer to the contracting authority (ECE/TRADE/154).

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Chapter VI. Settlement of disputes

CONTENTS

LEGISLATIVE RECOMMENDATIONS

Disputes between the contracting authority and the concessionaire (see paras. 3-42)

Recommendation 68. The contracting authority should be free to agree to dispute settlement mechanisms regarded by the parties as suited to the needs of the project, including arbitration.

[*Recommendation 68*bis. The law should indicate whether and, if so, to what extent the contracting authority may raise a plea of sovereign immunity, both as a bar to the commencement of arbitral or judicial proceedings as well as a defence against enforcement of the award or judgement.]

Disputes between the concessionaire and its lenders, contractors and suppliers (see para. 43)

Recommendation 69. The concessionaire and the project promoters should be free to choose the appropriate mechanisms for settling commercial disputes among project promoters or disputes between the concessionaire and its lenders, contractors, suppliers and other business partners.

Disputes between the concessionaire and its customers (see paras. 44-46)

Recommendation 70. The concessionaire may be required to make available simplified and efficient mechanisms for handling claims submitted by its customers or users of the infrastructure facility.

NOTES ON THE LEGISLATIVE RECOMMENDATIONS

A. GENERAL REMARKS

1. An important factor for the implementation of privately financed infrastructure projects is the legal framework in the host country for the settlement of disputes. Investors, contractors and lenders will be encouraged to participate in projects in countries where they have the confidence that any disputes arising out of contracts forming part of the project will be resolved fairly and efficiently. By the same token, efficient procedures for avoiding disputes or settling them expeditiously will facilitate the exercise of the contracting authority's monitoring functions and reduce the contracting authority's overall administrative cost. In order to create a more hospitable climate for investors, the legal framework of the host country should give effect to certain basic principles, such as the following: foreign firms should be guaranteed access to the courts under substantially the same conditions as domestic ones; parties to private contracts should have the right to choose foreign law as the law applicable to their contracts; foreign judgements should be enforceable; and there should be neither unnecessary restrictions to access to non-judicial dispute settlement mechanisms nor legal impediments for the creation of facilities for settling disputes amicably outside the judicial system.

2. Privately financed infrastructure projects typically require the establishment of a network of interrelated contracts and other legal relationships involving various parties. Legislative provisions dealing with the settlement of

disputes arising in the context of these projects must take account of the diversity of relations, which may call for different dispute settlement methods depending on the type of dispute and the parties involved. The main disputes may be divided into three broad categories:

(a) Disputes arising under agreements between the concessionaire and the contracting authority and other governmental agencies. In most civil law countries, the project agreement is governed by administrative law (see chap. VII, "Other relevant areas of law", paras. 24-27), while in other countries the agreement is in principle governed by contract law as supplemented by special provisions developed for government contracts for the provision of public services. This regime may have implications for the dispute settlement mechanism that the parties to the project agreement may be able to agree upon. Similar considerations may also apply to certain contracts entered into between the concessionaire and governmental agencies or government-owned companies supplying goods or services to the project or purchasing goods or services generated by the infrastructure facility;

(b) Disputes arising under contracts and agreements entered into by the project promoters or the concessionaire with related parties for the implementation of the project. These contracts usually include at least the following: (i) contracts between parties holding equity in the project company (e.g. shareholders' agreements, agreements regarding the provision of additional financing or arrangements regarding voting rights); (ii) financing and related agreements, which involve, apart from the project company, parties such as commercial banks, governmental lending institutions, international lending institutions and export credit insurers; (iii) contracts between the project company and contractors, which themselves may be consortia of contractors, equipment suppliers and providers of services; (iv) contracts between the project company and the parties who operate and maintain the project facility; and (v) contracts between the concessionaire and private companies for the supply of goods and services needed for the operation and maintenance of the facility;

(c) Disputes between the concessionaire and other parties. These other parties include the users or customers of the facility. These users may be, for example, a government-owned utility company that purchases electricity or water from the project company so as to resell it to the ultimate users; commercial companies, such as airlines or shipping lines contracting for the use of the airport or port; or individual persons paying for the use of a toll road. The parties to these disputes may not necessarily be bound by any prior legal relationship of a contractual or similar nature.

B. DISPUTES BETWEEN THE CONTRACTING AUTHORITY AND THE CONCESSIONAIRE

3. Disputes that arise under the project agreement frequently involve problems that do not often arise in connection with other types of contracts. This is due to the complexity of infrastructure projects and the fact that they are to be performed over a long period of time, with a number of enterprises participating in the construction and in the operational phases. In addition, disputes under project agreements may concern highly technical matters connected with the construction processes, the technology incorporated in the works and the conditions for operating the facility. Furthermore, these projects usually involve governmental agencies and a high level of public interest. These circumstances place emphasis on the need to have mechanisms in place that avoid as much as possible the escalation of disagreements between the parties and preserve their business relationship; that prevent the disruption of the construction works or the provision of the services; and that are tailored to the particular characteristics of the disputes that may arise.

4. Some of the main considerations particular to the various phases of implementation of privately financed infrastructure projects are discussed in this section. The settlement of the concessionaire's grievances in connection with decisions by regulatory agencies has been considered in the context of the authority to regulate infrastructure services (see chap. I, "General legislative and institutional framework", paras. 51-53). The settlement of disputes arising during the process of selecting a concessionaire (that is, pre-contractual disputes) has also been dealt with earlier in the *Guide* (see chap. III, "Selection of the concessionaire", paras. 118-122).

1. General considerations on methods for prevention and settlement of disputes

5. The issues that most frequently give rise to disputes during the life of the project agreement are those related to possible breaches of the agreement during the construction phase, the operation of the infrastructure facility or in connection with the expiry or termination of the project agreement. These disputes may be very complex and they often involve highly technical matters that need to be resolved speedily in order not to disrupt the construction or the operation of the infrastructure facility. For these reasons it is advisable for the parties to devise mechanisms that allow for the choice of competent experts to assist in the settlement of disputes. Furthermore, the long duration of privately financed infrastructure projects makes it important to devise mechanisms to prevent, as much as possible, disputes from arising so as to preserve the business relationship between the parties.

6. With a view to achieving the objectives mentioned above, project agreements often provide for composite dispute-settlement clauses designed to prevent, to the extent possible, disputes from arising, to foster reaching agreed solutions and to put in place efficient dispute settlement methods when disputes nevertheless arise. Such clauses typically provide for a sequential series of steps starting with an early warning of issues that may develop into a dispute unless the parties take action to prevent them. When a dispute does occur it is provided that the parties should exchange information and discuss the dispute with a view to identifying a solution. If the parties are unable to resolve the dispute themselves, then either party may require participation of an independent and impartial third party to assist them to find an acceptable solution. In most cases, adversarial dispute settlement mechanisms are only used when the disputes cannot be settled through the use of such conciliatory methods.

7. However, there may be limits to the parties' freedom to agree to certain dispute prevention or dispute settlement methods: one such limit may arise from the subject matter of the dispute; another limit may in some legal systems arise from the governmental character of the contracting authority. In some legal systems, the traditional position has been that the Government and its agencies may not agree on certain dispute settlement methods, in particular, arbitration. This position has often been restricted to mean that it does not apply to public enterprises of industrial or commercial character, which, in their relations with third parties, act pursuant to private law or commercial law.

8. Limitations to the freedom to agree on dispute settlement methods, including arbitration, may also relate to the legal nature of the project agreement. Under some civil law systems, project agreements may be regarded as administrative contracts, with the consequence that disputes arising thereunder need to be settled through the judiciary or through administrative courts of the host country. Under other legal systems, similar prohibitions may be expressly included in legislation or judicial precedents directly applicable to project agreements, or may be the result of established contract practices, usually based on legislative rules or regulations.

9. For countries that wish to allow the use of non-judicial methods, including arbitration, for the settlement of disputes arising in connection with privately financed infrastructure projects, it is important to remove possible legal obstacles and to provide a clear authorization for domestic contracting authorities to agree on dispute settlement methods. The absence of such legislative authority may give rise to questions as to the validity of the dispute-settlement clause and cause delay in the settlement of disputes. If, for example, an arbitral tribunal finds that the arbitration agreement has been validly concluded despite any subsequent defence that the contracting authority had no authorization to conclude it, the question may reappear at the recognition and enforcement stage before a court in the host country or before a court of a third country where the award is to be recognized or enforced.

2. Commonly used methods for preventing and settling disputes

10. The following paragraphs set out the essential features of methods used for preventing and settling disputes and consider their suitability for the various phases of large infrastructure projects, namely, the construction phase, the operational phase and the post-termination phase. Although the project agreement usually provides for composite dispute prevention and dispute settlement mechanisms, care should be taken to avoid excessively complex procedures or to impose too many layers of different procedures. The brief presentation of selected methods for dispute prevention and dispute settlement methods contained in the following paragraphs is intended to inform legislators about the particular features and usefulness of these various methods. It should not be understood as a recommendation for the use of any particular combination of methods.

(a) Early warning

11. Early warning provisions may be an important tool to avoid disputes. Under these provisions, if one of the parties to a contract feels that events that have occurred, or claims that the party intends to make, have the potential to cause disputes, these events or claims should be brought to the attention of the other party as soon as possible. Delays in making these claims are not only a source of conflict, because they are likely to surprise the other party and therefore create resentment and hostility, but they also render the claims more difficult to prove. For that reason, early warning provisions typically require the claiming party to submit a quantified claim, along with the necessary proof, within an established time period. To make the provision effective, a sanction is frequently included for non-compliance with the provision, such as the loss of the right to pursue the claim or an increased burden of proof. In infrastructure projects, early warning frequently refers to events that might adversely affect the quality of the works or the public services, increase their cost, cause delays or endanger the continuity of the service. Early warning provisions are therefore useful throughout the duration of an infrastructure project.

(b) Partnering

12. Another tool that is used as a means of dispute avoidance is partnering. The object of partnering is to create, through mutually developed formal strategies and from the outset of a project, an environment of trust, teamwork and cooperation among all key parties involved in the project. Partnering has been found to be useful to avoid disputes and to commit the parties to work efficiently to achieve the goals of the project. The partnering relationships are defined in workshops attended by the key parties to the project, and usually organized by the contracting authority. At the initial workshop, a mutual understanding of the concept of partnering is established, goals for the project for all the parties are defined and a procedure to resolve critical issues quickly is developed. At the conclusion of this workshop, a "partnering charter" is drafted and signed by the participants, signifying their commitment to work jointly towards the success of the project. The charter usually includes an issue resolution procedure designed to determine claims and resolve other problems, beginning at the lowest possible level of management and at the earliest possible opportunity. If a solution is not reached within a given time-frame, the issue is raised to the next level of management. Outsiders to the project are only called in if no agreement by the people responsible for the project is achieved.

(c) Facilitated negotiation

13. The purpose of this procedure is to aid the parties in the negotiation process. The parties appoint a facilitator at the commencement of the project. His function is to assist the parties in resolving any disputes, without providing subjective opinions on the issues, but rather coaxing them into analysing thoroughly the merits of their cases. This procedure is specially useful when there are numerous parties involved who would find it difficult to negotiate and coordinate all the differing opinions without such facilitation.

(d) Mediation and conciliation

14. The term "conciliation" is used in the *Guide* as a broad notion referring to proceedings in which a person or a panel assists the parties in an independent and impartial manner in their attempt to reach an amicable settlement of their dispute. Conciliation differs from negotiations between the parties in dispute (in which the parties would typically engage after the dispute has arisen) in that conciliation involves independent and impartial assistance to settle the dispute, whereas in settlement negotiations between the parties no third-person assistance is involved. The difference between conciliation and arbitration is that conciliation ends either in the settlement of the dispute agreed by the parties or it ends unsuccessfully; in arbitration, however, the arbitral tribunal imposes a binding decision on the parties, unless they have settled the dispute before the award is made. In practice, such conciliation proceedings are referred to by various expressions, including "mediation". Nevertheless, in the legal tradition of some countries, a distinction is drawn between conciliation and mediation to emphasize the fact that, in conciliation, a third party is trying to bring together the disputing parties to help them reconcile their differences, while mediation goes further by allowing the mediator to suggest terms for the resolution of the dispute. However, the terms "conciliation" and "mediation" are used as synonyms more frequently than not.

15. Conciliation is increasingly being increasingly practised in various parts of the world, including in regions where it was not commonly used in the past. This trend is reflected, inter alia, in the establishment of a number of private and public bodies offering conciliation services to interested parties. The conciliation procedure is usually private, confidential, informal and easily pursued. It may also be quick and inexpensive. The conciliator may assume multiple roles and is in general more active than a facilitator. He or she may frequently challenge the parties' position to stress weaknesses that usually facilitate agreement and, if authorized, may suggest possible settlement scenarios. The procedure is generally non-binding and the conciliator's responsibility is to facilitate settlement by directing the parties' attention to the issues and possible solutions, rather than passing judgement. This procedure is particularly useful when there are many parties involved and it would therefore be difficult to achieve an agreement by direct negotiations.

16. If the parties provide for conciliation in the project agreement, they will have to settle a number of procedural questions in order to increase the chance of a settlement. Settling such procedural questions is greatly facilitated by the incorporation into the contract, by reference, of a set of conciliation rules such as the UNCITRAL Conciliation Rules.[1] Other sets of conciliation rules have been prepared by various international and national organizations.

(e) Non-binding expert appraisal

17. This is a procedure where a neutral third party is charged with providing an appraisal on the merits of the dispute and suggested outcome. It serves as a "reality check" showing the contesting parties what the possible outcome of the more expensive and usually slower binding procedures such as arbitration or court proceedings would be. This procedure is useful where the parties have difficulty in communicating because their positions have become entrenched or where they do not see clearly the weaknesses of their positions or the strengths of the other party's positions. A non-binding expert appraisal is usually followed by negotiations, either direct or facilitated.

(f) Mini-trial

18. This procedure assumes the form of a mock trial in which site-level personnel of each party make submissions to a "tribunal" composed of a senior executive of each party and a third neutral person. After the submissions, which are typically to be made within predetermined time periods, the executives enter into a facilitated negotiation procedure with the assistance of a neutral person, to try to reach an agreement taking advantage of the issues that have been elucidated during the "trial". Counsel for the parties are frequently present and are useful in identifying the relevant issues. The purpose of the mini-trial is to inform senior executives of the issues involved in the dispute and to serve as a reality check of what the outcome of a real trial might be.

(g) Senior executive appraisal

19. This procedure is similar to the mini-trial but it is less adversarial and uses a more consensus-oriented approach. The procedure begins with the presentation of short position papers by each party, followed by short responses. At an "appraisal conference" headed by a facilitator, a senior executive from each of the parties makes brief oral presentations elucidating the issues submitted in the position papers or other points raised by the parties or the facilitator. This conference is followed by a negotiation meeting, chaired by the facilitator, with a view to reaching an agreement. Both the mini-trial and the senior executive appraisal tend to be less of a strong reality check than the non-binding expert appraisal and therefore less likely to motivate difficult decisions in the absence of commercial pressure to do so.

(h) Review of technical disputes by independent experts

20. During the construction phase, the parties may wish to consider providing for certain types of disputes to be referred to an independent expert appointed by both parties. This method may be of particular use in connection with disagreements relating to technical aspects of the construction of the infrastructure facility (for example, whether the works comply with contractual specifications or technical standards).

[1]For the report of the United Nations Commission on International Trade Law on the work of its thirteenth session, see *Official Records of the General Assembly, Thirty-fifth Session, Supplement No. 17* (A/35/17), para. 106 (*Yearbook of the United Nations Commission on International Trade Law*; vol. XI, 1980, part one, chap. II, sect. A (United Nations publication, Sales No. E.81.V.8)). The UNCITRAL Conciliation Rules have also been reproduced in booklet form (United Nations publication, Sales No. E.81.V.6). Accompanying the Rules is a model conciliation clause, which reads:"Where, in the event of a dispute arising out of or relating to this contract, the parties wish to seek an amicable settlement of that dispute by conciliation, the conciliation shall take place in accordance with the UNCITRAL Conciliation Rules as at present in force". The use of the UNCITRAL Conciliation Rules was recommended by the General Assembly in its resolution 35/52 of 4 December 1980.

21. The parties may, for instance, appoint a design inspector or a supervisor engineer, respectively, to review disagreements relating to the inspection and approval of the design, and the progress of construction works (see chap. IV, "Construction and operation of infrastructure", paras. 69-79). The independent experts should have expertise in the designing and construction of similar projects. The powers of the independent expert (such as whether the independent expert makes recommendations or issues binding decisions), as well as the circumstances under which the independent expert's advice or decision may be sought by the parties, should be set forth in the project agreement. In some large infrastructure projects, for instance, the advice of the independent expert may be sought by the concessionaire whenever there is a disagreement between the concessionaire and the contracting authority as to whether certain aspects of the design or construction works conform with the applicable specifications or contractual obligations. Referral of a matter to a design inspector or to a supervising engineer, as appropriate, may be particularly relevant in connection with provisions in the project agreement that require prior consent of the contracting authority for certain actions by the concessionaire, such as final authorization for operation of the infrastructure facility (see chap. IV, "Construction and operation of infrastructure", para. 78).

22. Independent experts have been often used for the settlement of technical disputes under construction contracts, and the various mechanisms and procedures developed in the practice of the construction industry may be used, mutatis mutandis, in connection with privately financed infrastructure projects. However, it should be noted that the scope of disputes between the contracting authority and the concessionaire is not necessarily the same as would be the case for disputes that typically arise under a construction contract. This is so because the respective positions of the contracting authority and the concessionaire under the project agreement are not fully comparable with those of the owner and the performer of works under a construction contract. For instance, disputes concerning the amount of payment due to the contractor for the quantities of works actually performed, which are frequent in construction contracts, are not typical for the relations between contracting authority and concessionaire, since the latter does not usually receive payments from the contracting authority for the construction works performed.

(i) Dispute review boards

23. Project agreements for large infrastructure projects often establish permanent boards composed of experts appointed by both parties, possibly with the assistance of an appointing authority, for the purpose of assisting in the settlement of disputes that may arise during the construction and the operational phases (referred to in the *Guide* as "dispute review boards"). Proceedings before a dispute review board can be informal and expeditious, and tailored to suit the characteristics of the dispute that it is called upon to settle. The appointment of a dispute review board may prevent misunderstandings or differences between the parties from developing into formal disputes that would require settlement in arbitral or judicial proceedings. In fact, its effectiveness as a tool for avoiding disputes is one of the special strengths of this procedure, but a dispute review board may also serve as a mechanism to resolve disputes, in particular when the board is given the power to render binding decisions.

24. Under the dispute review board procedure, the parties typically select, at the outset of the project, three experts renowned for their knowledge in the field of the project to constitute the board. These experts may be replaced if the project comprises different stages that may require different expertise (that is, different expertise will be required during the construction of the facility from during the later administration of the public service), and in some large infrastructure projects more than one board has been established. For example, one dispute review board may deal exclusively with disputes regarding matters of a technical nature (e.g. engineering design, fitness of certain technology, compliance with environmental standards) whereas another board may deal with disputes of a contractual or financial nature (regarding, for instance, the amount of compensation due for delay in issuing licences or disagreements on the application of price adjustment formulas). Each board member should be experienced in the particular type of project, including experience in the interpretation and administration of project agreements, and should undertake to remain impartial and independent of the parties. These persons may be furnished with periodic reports on the progress of construction or on the operation of the infrastructure facility, as appropriate, and may be informed immediately of differences arising between the parties. They may meet with the parties, either at regular intervals or when the need arises, to consider differences that have arisen and to suggest possible ways of resolving those differences.

25. In their capacity as agents to avert disputes, the members of the board may make periodic visits to the project site, meet with the parties and keep informed of the progress of the work. These meetings help identify any potential conflicts early, before they start festering and turn into full-fledged disputes. When potential conflicts are detected, the board proposes solutions, which, given the expertise and prestige of its members, are likely to be accepted by the parties. Referral of a dispute triggers an evaluation by the board, which is done in an informal manner, typically by discussion with the parties during a regular site visit. The board controls the discussion, but each party is given a full opportunity to state its views, and the dispute review board is free to ask questions and to request documents and other evidence. The advantages of conducting hearings at the job site, soon after the events have occurred and before adversarial positions have hardened, are obvious. The board then meets privately and seeks to formulate a recommendation or a decision. If the parties do not accept these proposals and disputes do arise, the board, if authorized to do so by the parties, is in a unique position to solve them expeditiously because of its familiarity with the problems and contractual documents.

26. Given their usually long duration, many circumstances relevant to the execution of privately financed infrastructure projects may change before the end of the concession term. While the impact of some changes may be

automatically covered in the project agreement (see chap. IV, "Construction and operation of infrastructure", paras. 126-130) there are changes that might not lend themselves easily to inclusion in an automatic adjustment mechanism or that the parties may prefer to exclude from such a mechanism. It is therefore important for the parties to establish mechanisms for dealing with disputes that may arise in connection with changing circumstances. This is of particular significance for the operational phase of the project. Where the parties have agreed on rules that allow a revision of the terms of the project agreement following certain circumstances, the question may arise as to whether those circumstances have occurred and, if so, how the contractual terms should be changed or supplemented. With a view to facilitating a resolution of possible disputes and avoiding a stalemate in case the parties are unable to agree on a contract revision, it is advisable for the parties to clarify whether and to what extent certain contractual terms may be changed or supplemented by the dispute review board. It may be noted, in this context, that the parties might not always be able to rely on an arbitral tribunal or a domestic court for that purpose. Indeed, under some legal systems, courts and arbitrators are not competent to change or supplement contractual terms. Under other legal systems, courts and arbitrators may do so only if they are expressly so authorized by the parties. Under yet other legal systems, arbitrators may do so but courts may not.

27. The law governing arbitral or judicial proceedings may determine the extent to which the parties may authorize arbitrators or a court to review a decision of the dispute review board. Excluding such review has the advantage that the decision of the dispute review board would be immediately final and binding. However, permitting such a review gives the parties greater assurance that the decision will be correct. Early clauses on dispute review boards did not provide that their recommendations would become binding if not challenged in arbitral or judicial proceedings. In practice, however, the combination of the persuasive force of unanimous recommendations by independent experts agreed by the parties has led both contracting authorities and project companies to accept the recommendations voluntarily rather than litigate. Recent contract provisions on dispute review boards usually provide that a decision of the board, while not immediately binding on the parties, becomes binding unless one or both parties refer the dispute to arbitration or initiate judicial proceedings within a specified period of time. Apart from avoiding potentially protracted litigation, the parties often take into account the potential difficulty of overcoming what might be regarded by the court or arbitral tribunal as a powerful recommendation, inasmuch as it had been made by independent experts familiar with the project from the outset and was based on contemporaneous observation of the project prior to, and at the time of, the dispute having first arisen.

28. Although this occurs very rarely, the parties may agree to make the board's decision final and binding. It should be noted, however, that despite the parties' agreement to be bound by the board's decision, under many legal systems, the decision by the dispute review board, while binding as a contract, may not be enforceable in a summary proceeding, such as a proceeding for the enforcement of an arbitral award, since it does not have the status of an arbitral award. If the parties contemplate providing for proceedings before a dispute review board, it will be necessary for them to settle various aspects of those proceedings in the project agreement. It would be desirable for the project agreement to delimit as precisely as possible the authority conferred upon the dispute review board. With regard to the nature of their functions, the project agreement might authorize the dispute review board to make findings of fact and to order interim measures. It mcy specify the functions to be performed by the dispute review board and the type of issues with which they may deal. If the parties are permitted to initiate arbitral or judicial proceedings within a specified period of time after the decision is rendered, the parties might specify that findings of fact made by a dispute review board are to be regarded as conclusive in arbitral or judicial proceedings. The project agreement might also obligate the parties to implement a decision by the dispute review board concerning interim measures or a decision on the substance of specified issues; if the parties fail to do so, they will be considered as having failed to perform a contractual obligation. Regarding the duration of the board's functions, the project agreement may provide that the board will continue to function for a certain period beyond the expiry or termination of the project agreement, in order to deal with disputes that may arise at that stage (for example, disputes as to the condition of and compensation due for assets handed over to the contracting authority).

(j) Non-binding arbitration

29. This procedure is sometimes used when less adversarial methods such as facilitated negotiation, conciliation or dispute review board procedures have been unsuccessful. Non-binding arbitration is conducted in the same manner as binding arbitration, and the same rules may be used except that the procedure ends with a recommendation. The procedure contemplates that the parties will proceed directly to litigation if the dispute is still unresolved under non-binding arbitration. Those who choose this procedure do so *(a)* if they have reservations about the binding nature of arbitration; or *(b)* as an incentive to avoid both arbitration and litigation, arbitration because it would seem redundant to go through the same procedure twice and litigation because of its length and cost.

(k) Arbitration

30. In recent years, arbitration has been used increasingly for settling disputes arising under privately financed infrastructure projects. Arbitration is typically used both for the settlement of disputes that arise during the construction or operation of the infrastructure facility and for the settlement of disputes related to the expiry or termination of the project agreement. Arbitration is preferred by private investors and lenders, in particular foreign ones, since arbitral proceedings may be structured by the parties so as to be less formal than judicial proceedings and better suited to the needs of the parties and to the specific features of the disputes likely to arise under the project agreement. The parties can choose as arbitrators persons who have expert knowledge of the particular type of project. They may choose the place where the arbitral proceedings are to be conducted. They can also choose the language or languages

to be used in the arbitral proceedings. Arbitral proceedings may be less disruptive of business relations between the parties than judicial proceedings. The proceedings and arbitral awards can be kept confidential, while judicial proceedings and decisions usually cannot. Furthermore, the enforcement of arbitral awards in countries other than the country in which the award was rendered is facilitated by the wide acceptance of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958.[2]

31. With regard, in particular, to infrastructure projects involving foreign investors, it may be noted that a framework for the settlement of disputes between the contracting authority and foreign companies participating in a project consortium may be provided through adherence to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.[3] The Convention, which has thus far been adhered to by 131 States, established the International Centre for the Settlement of Investment Disputes (ICSID). ICSID is an autonomous international organization with close links to the World Bank. 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 withdraw its consent unilaterally. All ICSID members, whether or not parties to the dispute, are required by the Convention to recognize and enforce ICSID arbitral awards. The consent of the parties to ICSID arbitration may be given with regard to an existing dispute or with respect to a defined class of future disputes. The consent of the parties need not, however, be expressed in relation to a specific project; a host country might in its legislation on the promotion of investment offer to submit disputes arising out of certain classes of investment to the jurisdiction of ICSID and the investor might give its consent by accepting the offer in writing.

32. Bilateral investment agreements may also provide a framework for the settlement of disputes between the contracting authority and foreign companies. In these treaties, the host State typically extends to investors that qualify as nationals of the other signatory State a number of assurances and guarantees (see chap. VII, "Other relevant areas of law", paras. 4-6) and expresses its consent to arbitration, for instance, by referral to ICSID or to an arbitral tribunal applying the UNCITRAL Arbitration Rules.

(i) Sovereign immunity

33. When arbitration is allowed and agreed upon between the parties to the project agreement, the implementation of an agreement to arbitrate may be frustrated or hindered if the contracting authority is able to plead sovereign immunity, either as a bar to the commencement of arbitral proceedings or as a defence against recognition and enforcement of the award. Sometimes the law on this matter is not clear, which may raise concerns with the interested parties (for instance, the concessionaire, project promoters and lenders) that an agreement to arbitrate might not be effective. In order to address such possible concerns, it is advisable to review the law on this topic and to indicate the extent to which the contracting authority may raise a plea of sovereign immunity.

34. In addition, a contracting authority against which an award has been issued may raise a plea of immunity from execution against public property. There is a diversity of approaches to the question of sovereign immunity from execution. For example, under some national laws immunity does not cover governmental entities when engaged in commercial activities. In other national laws a link is required between the property to be attached and the claim in that, for example, immunity cannot be pleaded in respect of funds allocated for economic or commercial activity governed by private law upon which the claim is based or that immunity cannot be pleaded with respect to assets set aside by the State to pursue its commercial activities. In some countries, it is considered that it is for the Government to prove that the assets to be attached are in non-commercial use.

35. In some contracts involving entities that might plea sovereign immunity, clauses have been included to the effect that the Government waives its right to plead sovereign immunity. Such a consent or waiver might be contained in the project agreement or an international agreement; it may be limited to recognizing that certain property is used or intended to be used for commercial purposes. Such written clauses may be necessary inasmuch as it is not clear whether the conclusion of an arbitration agreement and participation in arbitral proceedings by the governmental entity constitutes an implied waiver of sovereign immunity from execution.

36. The legislator may wish to review its laws on this matter and, to the extent considered advisable, clarify in which areas contracting authorities may not plead sovereign immunity.

(ii) Effectiveness of the arbitration agreement and enforceability of the award

37. The effectiveness of an agreement to arbitrate depends on the legislative regime where the arbitration takes place. If the legislative regime for arbitration in the host country is seen as unsatisfactory, for instance, because it is found to pose unreasonable restrictions on party autonomy, a party might wish to agree on a place of arbitration outside the host country. It is therefore important for the host country to ensure that the domestic legislative regime for arbitration resolves the principal procedural issues in a manner appropriate for international arbitration cases. Such a regime is contained in the UNCITRAL Model Law on International Commercial Arbitration.[4]

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[2]See United Nations, *Treaty Series*, vol. 330, No. 4739, p. 38, reproduced in the *Register of Conventions and Other Instruments concerning International Trade Law*; vol. II (United Nations publication, Sales No. E.73.V.3).

[3]United Nations *Treaty Series*, vol. ___, No. 8359, p. 160.

[4]For the report of the United Nations Commission on International Trade Law on the work of its eighteenth session. See *Official Records of the General Assembly, Fortieth Session, Supplement No. 17* (A/40/17), para. 332 and annex I. The General Assembly, in its resolution 40/72 of 11 December 1985, recommended that all States give due consideration to the Model Law on International Commercial Arbitration, in view of the desirability of uniformity of the law of arbitral procedures and the specific needs of international commercial arbitration practice.

38. If the arbitration takes place outside the host country or if an award rendered in the host country would need to be enforced abroad, the effectiveness of the arbitration agreement would also depend on legislation governing the recognition and enforcement of arbitral awards. The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (see para. 30), inter alia, deals with the recognition of an arbitration agreement and the grounds on which the court may refuse to recognize or enforce an award. The Convention is generally regarded as providing an acceptable and balanced regime for the recognition and enforcement of arbitral awards. The fact that the host country is a party to the Convention is likely to be seen as a crucial element in assessing the legal certainty of binding commitments and of the reliability of arbitration as a method for solving disputes by arbitration with parties from the country. It would also facilitate the enforcement abroad of an arbitral award rendered in the host country.

(l) Judicial proceedings

39. As indicated earlier, in some legal systems, pursuant to mandatory rules of a public law nature, the settlement of disputes arising out of project agreements whereby the concessionaire is entrusted with the provision of public services is a matter of the exclusive competence of the domestic judiciary or administrative courts. In some countries, governmental agencies lack the power to agree to arbitration, except under specific circumstances (see paras. 7-9), while in other legal systems the parties have the freedom to choose between judicial and arbitral proceedings.

40. Where it is possible for the parties to choose between judicial and arbitral proceedings, the contracting authority may see reasons for leaving any dispute to be resolved by the courts of the host country. Those courts are familiar with the law of the country, which often includes specific legislation directly applicable to the project agreement. Furthermore, the contracting authority and other governmental agencies of the host country that might be involved in the dispute may prefer local courts because of the familiarity with the court procedures and the language of the proceedings. It may also be considered that, to the extent project agreements involve issues of public policy and the protection of public interest, State courts are in a better position to give them proper effect.

41. However, such a view by the contracting authority may not be shared by prospective investors, financiers and other private parties. These parties may consider that arbitration is preferable to judicial proceedings because arbitration, being to a larger degree subject to the agreement of the parties than judicial proceedings, is in a position to resolve a dispute more efficiently. Private investors, in particular foreign ones, may also be reluctant to submit to the jurisdiction of domestic courts functioning under rules unfamiliar to them. In some countries it has been found that allowing the parties to choose the dispute settlement mechanism helped to attract foreign investment for the development of its infrastructure.

42. In considering whether any dispute should be resolved in judicial proceedings or whether an arbitration agreement should be entered into, where such choice is permitted under the applicable law, factors typically taken into account by the parties include, for example, their confidence that the courts competent to decide a dispute will be unbiased and that the dispute will be resolved without inordinate delay. The efficiency of the national judicial system and the availability of forms of judicial relief that are adequate to disputes that might arise under the project agreement are additional factors to be taken into account. Furthermore, in view of the highly technical and complex issues involved in infrastructure projects, the parties will also consider the implications of using arbitrators selected for their particular knowledge and experience as compared to domestic courts which may lack specific knowledge or experience in handling the technical questions in the area where the dispute arose. Another consideration may be the confidentiality of arbitration proceedings, relative informality of arbitral procedures, and the possibly greater flexibility arbitrators may have in awarding appropriate remedies, all of which may be beneficial for preserving and developing the long-term relationship implicit in project agreements.

C. DISPUTES BETWEEN THE CONCESSIONAIRE AND ITS LENDERS, CONTRACTORS AND SUPPLIERS

43. It is generally accepted in domestic laws that parties to commercial transactions, and in particular international commercial transactions, are free to agree on the forum that will decide in a binding decision any dispute that may arise from those transactions. In international transactions, arbitration has become the preferred method, whether or not it is preceded by, or combined with, conciliation. As to contracts between the concessionaire and the lenders, contractors and suppliers, which invariably form part of privately financed infrastructure projects, in many countries the parties are free to subject disputes to arbitration, to select the place of arbitration and to determine whether or not any arbitration case should be administered by an arbitral institution. These contracts are generally considered commercial agreements to which, as regards dispute settlement clauses, general rules regarding commercial contracts are applicable. Host countries wishing to establish a hospitable legal climate for privately financed infrastructure projects would be well advised to review their laws with respect to these contracts so as to eliminate any uncertainty regarding the freedom of the parties to agree to dispute settlement mechanisms of their choice.

D. DISPUTES BETWEEN THE CONCESSIONAIRE AND ITS CUSTOMERS

44. Depending on the type of project, the concessionaire's customers may include various persons and entities, such as, for example, a government-owned utility company that purchases electricity or water from the concessionaire so as to resell it to the ultimate users; commercial companies, such as airlines or shipping lines contracting for the use of the airport or port; or individual persons paying for the use of a toll road. The considerations and policies regarding contracts with the end-purchasers of the goods or services supplied by the project company may vary according to

who the parties to those contracts are, the conditions under which the services are provided and the applicable regulatory regime.

45. In some countries, public service providers are required by law to establish special simplified and efficient mechanisms for handling claims brought by their customers. Such special regulation is typically limited to certain industrial sectors and applies to purchases of goods or services by customers. Statutory requirements for the establishment of such dispute settlement mechanisms may apply generally to claims brought by any of the concessionaire's customers or may be limited to customers who are individual persons acting in their non-commercial capacity. The concessionaire's obligation may be limited to the establishment of a mechanism for receiving and dealing with complaints by individual consumers. Such mechanisms may include a special facility or department set up within the project company for receiving and handling claims expeditiously, for instance by making available to the customers standard claim forms or toll-free telephone numbers for voicing grievances. If the matter is not satisfactorily resolved, the customer may have the right to file a complaint with a regulatory agency, if any, which in some countries may have the authority to issue a binding decision on the matter. Such mechanisms are often optional for the consumer and typically do not preclude resort by the aggrieved persons to courts.

46. If the customers are utility companies (such as a power distribution company) or commercial enterprises (for instance, a large factory purchasing power directly from an independent producer) who freely choose the services provided by the concessionaire and negotiate the terms of their contracts, the parties would typically settle any disputes by methods usual in trade contracts, including arbitration. Accordingly, there may not be a need for addressing the settlement of these disputes in legislation relating to privately financed infrastructure projects. However, where the concessionaire's customers are government-owned entities, their ability to agree on dispute settlement methods may be limited by rules of administrative law governing the settlement of disputes involving governmental entities. For countries that wish to allow the use of non-judicial methods, including arbitration, for the settlement of disputes between the concessionaire and its government-owned customers, it is important to remove possible legal obstacles and to provide a clear authorization for those entities to agree on dispute settlement methods (see paras. 7-9).

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Chapter VII. Other relevant areas of law

CONTENTS

A. GENERAL REMARKS

1. The stage of development of the relevant laws of the host country, the stability of its legal system and the adequacy of remedies available to private parties are essential elements of the overall legal framework for privately financed infrastructure projects. By reviewing and, as appropriate, improving its laws in those areas of immediate relevance for privately financed infrastructure projects, the host country will make an important contribution to securing a hospitable climate for private sector investment in infrastructure. Greater legal certainty and a favourable legal framework will translate into a better assessment of country risks by lenders and project sponsors. This will have a positive influence on the cost of mobilizing private capital and reduce the need for governmental support or guarantees (see chap. II, "Project risks and government support", paras. 30-60).

2. Section B points out a few selected aspects of the laws of the host country that, without necessarily dealing directly with privately financed infrastructure projects, may have an impact on their implementation (see paras. 3-52). Section C indicates the possible relevance of a few international agreements for the implementation of privately financed infrastructure projects in the host country (see paras. 53-57).

B. OTHER RELEVANT AREAS OF LAW

3. In addition to issues pertaining to legislation directed specifically towards privately financed infrastructure projects, a favourable legal framework also requires supportive provisions in other areas of legislation. Private investment in infrastructure will be encouraged by the existence of legislation that promotes and protects private investment in economic activities. The following paragraphs pinpoint only a few selected aspects of other fields of law that may have an impact on the implementation of infrastructure projects. The existence of adequate legal provisions in those other fields may facilitate a number of transactions necessary to carry out infrastructure projects and help to reduce the perceived legal risk of investment in the host country.

1. Promotion and protection of investment

4. One matter of particular concern for the project consortia and the lenders is the degree of protection afforded to investment in the host country. Foreign investors in the host country will require assurances that they will be protected from nationalization or dispossession without judicial review and appropriate compensation in accordance with the rules in force in the host country and in accordance with international law. Project promoters will also be concerned about their ability, inter alia, to bring to the country without unreasonable restriction the qualified personnel required to work with the project, to import needed goods and equipment, to gain access to foreign exchange as needed and to transfer abroad or repatriate their profits or sums needed to repay loans that the company has entered into for the purpose of the infrastructure project. In addition to specific guarantees that may be provided by the Government (see chap. II, "Project risks and government support", paras. 45-50), legislation on promotion and protection of investment may play an important role in connection with privately financed infrastructure projects. 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.

5. An increasing number of countries have entered into bilateral investment agreements that 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 (payment of dividends abroad or repatriation of investment, for example); 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 project sponsors 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. Multilateral treaties may also be a source of investment protection provisions.

6. Moreover, in a number of countries rules aimed at facilitating and protecting the flow of investment (which also include areas such as immigration legislation, import control and foreign exchange rules) are contained in legislation that might not necessarily be based on a bilateral or multilateral treaty

2. Property law

7. It is desirable for the property laws of the host country to reflect acceptable international standards, contain adequate provisions on the ownership and use of land and buildings, as well as movable and intangible property, and ensure the concessionaire's ability to purchase, sell, transfer and license the use of property, as appropriate. Constitutional provisions protecting property rights have been found to be important factors in fostering private investment in many countries.

8. Where the concessionaire owns the land on which the facility is built, it is important that the ownership of the land can be clearly and unequivocally established through adequate registration and publicity procedures. The concessionaire and lenders will need clear 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.

9. It is also necessary to provide effective mechanisms for the enforcement of the property and possessory rights granted to the concessionaire against violation by third parties. Enforcement should also extend to easements and

rights of way that may be needed by the concessionaire for providing and maintaining the relevant service (such as placing of poles and cables on private property to ensure the distribution of electricity) (see chap. IV, "Construction and operation of infrastructure", paras. 30-35).

3. Security interests

10. As indicated earlier (see chap. IV, "Construction and operation of infrastructure", paras. 52-61), security arrangements in privately financed infrastructure projects may be complex and consist of a variety of forms of security, including fixed security over physical assets of the concessionaire (for example, mortgages or charges), pledges of shares of the concessionaire and assignment of intangible assets (receivables) of the project. While the loan agreements are usually subject to the governing law chosen by the parties, the laws of the host country will in most cases determine the type of security that can be enforced against assets located in the host country and the remedies available.

11. Differences in the type of security or limitations in the remedies available under the laws of the host country may be a cause of concern to potential lenders. 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. Because of the significant differences between legal systems regarding the law of security interests, the *Guide* does not discuss in detail the technicalities of the requisite legislation and the following paragraphs provide only a general outline of the main elements of a modern regime for secured transactions.

12. In some legal systems, security interests can be created in virtually all kinds of assets, including intellectual property, whereas in other systems security interests can only be created in a limited category of assets, such as land and buildings. In some countries, security interests can be created over assets that do not yet exist (future assets) and security may be taken over all of a company's assets, while allowing the company to continue to deal with those assets in the ordinary course of business. Some legal systems provide for a non-possessory security interest, so that security can be taken over assets without taking actual possession of the assets; in other systems, as regards those assets which are not subject to a title registration system, security may only be taken by physical possession or constructive possession. Under some systems, enforcement of the security interest can be undertaken without court involvement, whereas in other systems it may only be enforced through court procedures. Some countries provide enforcement remedies that not only include sale of the asset, but also enable the secured lender to operate the asset either by taking possession or appointing a receiver; in other countries, judicial sale may be the primary enforcement mechanism. Under some systems, certain types of security will rank ahead of preferential creditors, whereas in others the preferential creditors rank ahead of all types of security. In some countries, creation of a security interest is cost-efficient, with minimal fees and duties payable, whereas in other countries it can be costly. In some countries, the value of the amount of security taken may be unlimited, while in others the value of security cannot be excessive in comparison with the debt owed. Some legal systems impose obligations on the secured lender on enforcement of the security, such as the obligation to take steps ensuring that assets will be sold at fair market value.

13. Basic legal protection may include provisions ensuring that fixed security (such as a mortgage) is a registrable interest and that, once such security is registered in the 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. This may be difficult, since in many countries no specialized registers of title exist. Furthermore, security should be enforceable against third parties, which may require that they 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.

14. Another important aspect concerns the flexibility given to the parties to define the assets that 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.

15. Given the long-term nature of privately financed infrastructure projects, the parties may wish to be able to define the assets that are given as security specifically or generally. They may also wish such security to cover present or future assets and assets that 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.

16. Thus far, no comprehensive uniform regime or model for the development of domestic security laws has been developed by international intergovernmental bodies. Governments might be advised, however, to take account of various efforts being undertaken in different organizations. 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. 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.

[*Note for the Commission: Appropriate reference will be made to the draft convention on assignment in receivables financing developed by the Working Group on International Contract Practices, as well as to other international initiatives (such as the draft model inter-American law on secured transactions currently being considered by the Organization of American States in the context of preparations for the Sixth Inter-American Conference on Private International Law and the UNIDROIT draft convention on international interests in mobile equipment).*]

4. Intellectual property law

17. 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 proponent's proprietary information under copyright protection. Therefore, private investors, national and foreign, bringing new or advanced technology into the host 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, which may require the enactment of criminal law provisions designed to combat infringements of intellectual property rights.

18. A legal framework for the protection of intellectual property may be provided by adherence to international agreements regarding the protection and registration of intellectual property rights. It would be desirable to strengthen the protection of intellectual property rights in line with such instruments as the Paris Convention for the Protection of Industrial Property of 1883.[1] The Convention applies to industrial property in the widest sense, including inventions, marks, industrial designs, utility models, trade names, geographical indications and the repression of unfair competition. The Convention provides that, as regards the protection of industrial property, each contracting State must grant national treatment. It also provides for the right of priority in the case of patents, marks and industrial designs and establishes a few common rules that all the contracting States must follow in relation to patents, marks, industrial designs, trade names, indications of source, unfair competition and national administrations. A framework for further international patent protection is provided under the Patent Cooperation Treaty of 1970, which makes it possible to seek patent protection for an invention simultaneously in each of a large number of countries by filing an international patent application. In some countries, international standards are supplemented by legislation aimed at affording legal protection to new technological developments, such as legislation that protects intellectual property rights in computer software and computer hardware design.

19. Other important instruments providing international protection of industrial property rights are the Madrid Agreement Concerning the International Registration of Marks of 1891,[2] the Protocol Relating to the Madrid Agreement of 1989 and the Common Regulations under the Madrid Agreement and the Protocol Relating thereto of 1998. The Madrid Agreement provides for the international registration of marks (both trademarks and service marks) at the International Bureau of the World Intellectual Property Organization (WIPO). International registration of marks under the Madrid Agreement has effect in several countries, potentially in all the contracting States (except the country of origin). Furthermore, the Trademark Law Treaty of 1994 simplifies and harmonizes procedures for the application for registration of trademarks, changes after registration and renewal.

20. In the area of industrial designs, the Hague Agreement Concerning the International Deposit of Industrial Designs of 1925[3] provides for the international deposit of industrial designs at the International Bureau of WIPO. The international deposit has, in each of the contracting States designated by the applicant, the same effect as if all the formalities required by the domestic law for the grant of protection had been complied with by the applicant and as if all administrative acts required to that end had been accomplished by the office of that country.

21. The most comprehensive multilateral agreement on intellectual property to date is the Agreement on Trade-Related Aspects of Intellectual Property Rights (the "TRIPS Agreement") which was negotiated under the auspices of the World Trade Organization (WTO) and came into effect on 1 January 1995. The areas of intellectual property that it covers are copyright and related rights (that is, the rights of performers, producers of sound recordings and broadcasting organizations); trademarks, including service marks; geographical indications, including appellations of origin; industrial designs; patents, including the protection of new varieties of plants; the layout-designs of integrated circuits; and undisclosed information, including trade secrets and test data. In respect of each of the main areas of intellectual property covered by it, the TRIPS Agreement sets out the minimum standards of protection to be provided by each contracting party by requiring, first, compliance with the substantive obligations, inter alia, of the Paris Convention in its most recent version. The main substantive provisions of the Paris Convention are incorporated by reference and thus become obligations under the TRIPS Agreement. The TRIPS Agreement also adds a substantial number of additional obligations on matters where the pre-existing conventions on intellectual property are silent or were seen as being inadequate. In addition to that, the Agreement lays down certain general principles applicable to all procedures for the enforcement of intellectual property rights. Furthermore, the TRIPS Agreement contains provisions on civil and administrative procedures and

[1] As revised at Brussels on 14 December 1900, at Washington, D.C., on 2 June 1911, at The Hague on 6 November 1925, at London on 2 June 1934, at Lisbon on 31 October 1958 and at Stockholm on 14 July 1967 and as amended on 2 October 1979.

[2] As revised at Brussels on 14 December 1900, at Washington, D.C., on 2 June 1911, at The Hague on 6 November 1925, at London on 2 June 1934, at Nice on 15 June 1957 and at Stockholm on 14 July 1967.

[3] With the Additional Act of Monaco of 1961, the Complementary Act of Stockholm of 1967 as amended on 28 September 1979 and the Regulations Under the Hague Agreement Concerning the International Deposit of Industrial Designs of 1998.

remedies, provisional measures, special requirements related to border measures and criminal procedures, which specify, in a certain amount of detail, the procedures and remedies that must be available so that intellectual property rights can effectively be enforced by their holders.

5. Rules and procedures on compulsory acquisition of private property

22. Where the Government assumes responsibility for providing the land required for the implementation of the project, that land may be either purchased from its owners or, if necessary, compulsorily acquired against the payment of adequate compensation by procedures sometimes referred to as "compulsory acquisition" or "expropriation" (see chap. IV, "Construction and operation of infrastructure", paras. 20-22). Many countries have legislation governing compulsory acquisition of private property and that legislation would probably apply to the compulsory acquisition of property required for privately financed infrastructure projects.

23. Compulsory acquisition may be carried out in judicial or administrative proceedings or may be effected by an ad hoc legislative act. In most cases, the proceedings involve both administrative and judicial phases, which may be lengthy and complex. The Government may thus wish to review existing provisions on compulsory acquisition 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, while affording adequate protection to the rights of the owners. To the extent permitted by law, it is important to enable the Government to take possession of the property without unnecessary delay, so as to avoid increased project costs.

6. Rules on government contracts and administrative law

24. In many legal systems belonging to or influenced by the tradition of civil law, the provision of public services may be governed by a body of law known as "administrative law", which regulates a wide range of governmental functions. Such systems operate under the principle that the Government can exercise its powers and functions either by means of an administrative act or an administrative contract. It is also generally understood that, alternatively, the Government may enter into a private contract, subject to the law governing private commercial contracts. The differences between the two types of contract may be significant.

25. Under the concept of the administrative contract, the freedom and autonomy enjoyed by the parties to a private contract are subordinate to the public interest. In some legal systems, the Government has the right to modify the scope and terms of administrative contracts or even terminate them for reasons of public interest, usually subject to compensation for loss sustained by the private contracting party (see chap. V, "Duration, extension and termination of the project agreement", ___). 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. This is often balanced by the requirement that other changes may be made to the contract as may be necessary to restore the original financial equilibrium between the parties and to preserve the contract's general value for the private contracting party (see chap. IV, "Construction and operation of infrastructure", paras. 126-130). In some legal systems, disputes arising out of government contracts are subject to the exclusive jurisdiction of special tribunals dealing solely with administrative matters, which in some countries are separate from the judicial system (see chap. VI, "Settlement of disputes", ___).

26. 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. Although in other legal systems influenced by the tradition of common law no such categorical distinction is made between administrative contracts and private contracts, similar consequences may be achieved by different means. While under such systems of law it is frequently held that the rule of law is best maintained by subjecting the Government to ordinary private law, it is generally recognized that the administration cannot by contract fetter the exercise of its sovereign functions. It cannot hamper its future executive authority in the performance of those governmental functions which affect the public interest. Under the doctrine of sovereign acts, which is upheld in some common law jurisdictions, the Government as contractor is excused from the performance of its contracts if the Government as sovereign enacts laws, regulations or orders in the public interest that prevent that performance. Thus, the law may permit a public authority to interfere with vested contractual rights. Usually such action is limited so that the changes cannot be of such magnitude that the other party could not fairly adapt to them. In those circumstances, the private party is ordinarily entitled to some sort of compensation or equitable adjustment. In anticipation of such possibilities, in some countries a standard "changes" clause is included in a governmental contract that enables the Government to alter the terms on a unilateral basis or that provides for changes as a result of an intervening sovereign act.

27. Special prerogatives for governmental agencies are justified in those legal systems by reasons of public interest. It is however recognized that special governmental prerogatives, in particular the power to alter the terms of contracts unilaterally, may, if improperly used, adversely affect the vested rights of government contractors. For this reason, countries with a well-established tradition of private participation in infrastructure projects have developed a series of control mechanisms and remedies to protect government contractors against arbitrary or improper acts by public authorities, such as access to impartial dispute settlement bodies and full compensation schemes for governmental wrongdoing. Where protection of this nature is not afforded, rules of law providing public authorities with special prerogatives may be regarded by potential investors as an imponderable risk, which may discourage them from investing in particular jurisdictions. For this reason, some countries have reviewed their legislation on government contracts so as to provide the degree of protection needed to foster private investment and remove those provisions which gave rise to concern about the long-term contractual stability required for infrastructure projects.

7. Private contract law

28. The laws governing private contracts play an important role in connection with contracts entered into by the concessionaire with subcontractors, suppliers and other private parties. The domestic law on private contracts should provide adequate solutions to the needs of the contracting parties, including flexibility in devising the contracts needed for the construction and operation of the infrastructure facility. Apart from 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 those projects. An adequate set of rules of private international law is also important, given the likelihood that contracts entered into by the concessionaire will include some international elements.

29. Where new infrastructure is to be built, the concessionaire may need to import large quantities of supplies and equipment. Greater legal certainty for such transactions will be ensured 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)[4] or other international instruments dealing with specific contracts, such as the UNIDROIT Convention on International Financial Leasing (Ottawa, 1988),[5] drawn up by the International Institute for the Unification of Private Law (UNIDROIT).

8. Company law

30. In most projects involving the development of a new infrastructure, the project promoters will establish the project company as a separate legal entity in the host country (see chap. IV, "Construction and operation of infrastructure", paras. 12-18). It is recognized that the project company may take various forms in different countries, which may not necessarily entail a corporation. As in most cases it is a corporate form that is selected, it is particularly important for the host country 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. Furthermore, the recognition of the investors' ability to establish separate entities to serve as special-purpose vehicles for raising financing and disbursing funds may facilitate the closing of project finance transactions (see chap. IV, "Construction and operation of infrastructure", para. 59).

31. Although various corporate forms may be used, a common characteristic is that the concessionaire's owners (or shareholders) will require that their liability be limited to the value of their shares in the company's capital. If it is intended that the concessionaire 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 concessionaire. 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 concessionaire to obtain funds from investors on the security market, thus facilitating the financing of certain infrastructure projects.

32. Legislation should establish the responsibilities of directors and administrators of the concessionaire, including the basis for criminal responsibility. It can also set out provisions for the protection of third parties affected by any breach of corporate responsibility. 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 any other person's financial interests to the detriment of the company. Provisions intended to curb conflicts of interest in corporate management may be particularly relevant in connection with infrastructure projects, where the concessionaire may wish to engage its own shareholders, at some stage of the project, to perform work or provide services in connection with it (see chap. IV, "Construction and operation of infrastructure", paras. 100 and 101).

33. 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 (the board of directors or supervisory board, for example). 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. Mechanisms for the settlement of disputes among shareholders are also critical. It is useful to recognize the right of the shareholders to regulate a number of additional matters concerning the management of the concessionaire through agreements among themselves or through management contracts with the directors of the concessionaire.

9. Tax law

34. In addition to possible tax incentives that may be generally available in the host country or that may be specially granted to privately financed infrastructure projects (see chap. II, "Project risks and government support", paras. 51-54), 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

[4] *Official Records of the United Nations Conference on Contracts for the International Sale of Goods, Vienna, 10 March-1 April 1980* (United Nations publication, Sales No. E.82.V.5), part I.

[5] *Acts and Proceedings of the Diplomatic Conference for the adoption of the draft Unidroit Conventions on International Factoring and International Financial Leasing, Ottawa, 9-28 May 1988*, vol. I.

overall transparency of the domestic taxation system, the degree of discretion exercised by taxation authorities, the clarity of guidelines and instructions issued to taxpayers and the objectivity of criteria used to calculate tax liabilities. This may be a complex matter, in particular in those countries where the authority to establish or increase taxes or to enforce tax legislation has been decentralized.

35. Privately financed infrastructure projects are typically highly leveraged and require a predictable cash flow. For that reason, it is crucial for all potential tax implications to be readily assessable throughout the life of the project. Unanticipated changes in the taxes that reduce that cash flow can have serious consequences for the project. In some countries, the Government is authorized to enter into agreements with the investors for the purpose of guaranteeing that the cash flow of the project will not be adversely affected by unexpected increases in taxation. Such arrangements are sometimes referred to as "tax stabilization agreements". However, the Government may be restrained, by constitutional law or for political reasons, from providing this type of guarantee, in which case the parties may agree on compensation or contractual revision mechanisms for dealing with cost increases due to tax changes (see also chap. IV, "Construction and operation of infrastructure", paras. 122-125).

36. Most national tax regimes fall into one of three general categories. One approach is worldwide taxation with credits, in which all income earned anywhere is taxed in the home country and double taxation is avoided through the use of a foreign tax credit system; home country taxes are reduced by the amount of foreign taxes already paid. If this approach is used by an investor's home country, the investor's tax liability can be no less than it would be at home. Under a different taxation approach, the foreign income that has already been subject to foreign tax is exempt from taxation by the home country of the investor. Under a territorial approach, foreign income is exempt from home country taxation altogether. Investors in home countries that use the latter two systems of taxation would benefit from tax holidays and lower tax rates in the host country, but such tax relief would offer no incentive to an investor located in a tax haven.

37. The parties involved in the project may have different concerns over potential tax liability. Investors are usually concerned about the taxation of profits earned in the host country, taxation on payments made to contractors, suppliers, investors and lenders, and tax treatment of any capital gains (or losses) when the concessionaire is wound up. Investors may find that payments used to reduce taxes under their home country regime (such as payments for interest on borrowed funds, investigation costs, bidding costs and foreign exchange losses) may not be available in the host country, or vice versa. Since foreign tax credits are only allowed for foreign income taxes, investors need to ensure that any income tax paid in the host country satisfies the definition of income tax of their own country's taxing authority. Similarly, the project company in the host country may be treated for tax purposes as a different type of entity in the home country. In projects where the assets become public property, this may preclude deductions for depreciation under the laws of the home country.

38. One particular problem of privately financed infrastructure projects involving foreign investment is the possibility that foreign companies participating in a project consortium may be exposed to double taxation, that is, taxation of profits, royalties and interests in their own home countries as well as in the host country. The timing of tax payments and requirements to pay withholding taxes can also pose problems. 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 project sponsors often plays a role in their tax considerations.

39. Ultimately, it is the cumulative effect of all taxes combined that needs to be taken into consideration. For example, there may be taxes imposed by more than one level of taxing authority; in addition to taxation by the national Government, the concessionaire may also face municipal or provincial taxes. There may also be certain levies other than income taxes, which often are due and payable before the concessionaire has earned any revenues. These include sales taxes, sometimes referred to as "turnover taxes", value-added taxes, property taxes, stamp duties and import duties. Sometimes special provisions can be made to offer relief from these payments as well.

10. Accounting rules and practices

40. In several countries, companies are required by law to follow internationally acceptable standard accounting practices and retain the services of professional accountants or accounting auditors. Among the reasons for this is that the adoption of standard accounting practices is a measure taken to achieve uniformity in the valuation of businesses. In connection with the selection of the concessionaire, the use of standard accounting practices may also facilitate the task of evaluating the financial standing of bidders in order to determine whether they meet the pre-selection criteria required by the contracting authority (see chap. III, "Selection of the concessionaire", paras. 38-40). Standard accounting practices are also essential for carrying out audits of the profits of companies, which may be required for the application of tariff structures and the monitoring of the concessionaire's performance by the regulatory body (see chap. IV, "Construction and operation of infrastructure", paras. 39-46).

41. Special accounting rules for infrastructure operators have also been introduced in some countries to take into account the particular revenue profile of infrastructure projects. Projects involving the construction of infrastructure facilities, in particular roads and other transportation facilities, are typically characterized by a relatively short investment period, with high financial cost and no revenue stream, followed by a longer period with increasing revenue and decreasing financial cost and, under normal circumstances, stable operating costs. Accordingly, if traditional accounting rules were applied, the particular financial structure of such projects would need to be recorded in the project company's accounts as a period of continuous negative results followed by a long period of net profit. This would not only have negative conse-

quences, for instance, for the project company's credit rating during the construction phase, but might also result in a disproportionate tax debt during the operational phase of the project. In order to avoid such a distortion, some countries have adopted special accounting rules for companies undertaking infrastructure projects that take into account the fact that the financial results of privately financed infrastructure projects may only become positive on a medium-term basis. Those special rules typically authorize infrastructure developers to defer part of the financial cost accrued during the deficit phase to the subsequent financial years, in accordance with financial schedules provided in the project agreement. However, the special accounting rules are typically without prejudice to other rules of law that may prohibit the distribution of dividends during financial years closed with negative results.

11. Environmental protection

42. Environmental protection encompasses a wide variety of issues, ranging from handling of wastes and hazardous substances to relocation of persons displaced by large land-use projects. It is widely recognized that environmental protection is a critical prerequisite to sustainable development. Environmental protection legislation is likely to have a direct impact on the implementation of infrastructure projects at various levels, and environmental matters are among the most frequent causes of disputes. Environmental protection laws may include various requirements, such as the consent by various environmental authorities, evidence of no outstanding environmental liability, assurances that environmental standards will be maintained, commitments to remedy environmental damage and notification requirements. These laws often require prior authorization for the exercise of a number of business activities, which may be particularly stringent for some types of infrastructure (for instance, waste water treatment, waste collection, the coal-fired power sector, power transmission, roads and railways).

43. It is therefore advisable to include in legislation measures that make obligations arising from environmental laws transparent. It is important 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 and the circumstances that justify the denial or withdrawal of a licence. Particularly important are provisions that guarantee the applicant's access to expeditious appeals procedures and judicial recourse, as appropriate. It may also be advisable to ascertain to the extent possible, prior to the final award of the project, whether the conditions for obtaining the required environmental licences are met. In some countries, special public authorities or advocacy groups may have the 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 has been found useful to involve representatives of the public in the proceedings that lead to the issuance of environmental licences. The legislation may also establish the range of penalties that may be imposed and specify the parties that may be held responsible for the damage.

44. Adhering to treaties relating to the protection of the environment may help to strengthen the international regime of environmental protection. A large number of international instruments have been developed in the past decades to establish common international standards. These include the following: Agenda 21[6] and the Rio Declaration on Environment and Development,[7] adopted by the United Nations Conference on Environment and Development in 1992; the World Charter for Nature (General Assembly resolution 37/7, annex); the Basel Convention on the Control of Transboundary Movement of Hazardous Wastes and Their Disposal of 1989; the Convention on Environmental Impact Assessment in a Transboundary Context of 1991; and the Convention on the Protection and Use of Transboundary Watercourses and International Lakes of 1992.

12. Consumer protection laws

45. A number of countries have special rules of law on consumer protection. Consumer protection laws vary greatly from country to country, both in the way they are organized and in their substance. Nevertheless, consumer protection laws often include provisions such as favourable time limits for asserting claims and enforcing contractual rights; special rules for the interpretation of contracts whose terms are not usually negotiated with the consumer (sometimes referred to as "adhesion contracts"); extended warranties in favour of consumers; special termination rights; access to simplified dispute settlement instances (see also chap. VI, "Settlement of disputes", ___) or other protective measures.

46. From the concessionaire's perspective, it is important to consider whether the host country's laws on consumer protection may limit or hinder the concessionaire's ability to enforce, for instance, its right to obtain payment for the services provided, to adjust prices or to discontinue services to customers who breach essential terms of their contracts or violate essential conditions for the provision of the services.

13. Insolvency law

47. 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 such situations, including rules that enable the contracting authority to take the measures required to ensure the continuity of the project (see chap. V, "Duration, extension and termination of the project agreement", ___). The continuity in the provision of the service may be achieved by means of a legal framework that allows for the rescue of enterprises facing financial difficulties, such as reorganization and similar proceedings. In the event that bankruptcy proceedings become inevitable, the secured lenders will be specially concerned about provisions concerning secured claims, in particular as to whether secured creditors may

[6]Report of the United Nations Conference on Environment and Development, Rio de Janeiro, 3-14 June 1992 (United Nations publication, Sales No. E.93.I.8 and corrigenda), vol. I, *Resolutions Adopted by the Conference*, resolution 1, annex II.

[7]Ibid., annex I.

foreclose on the security despite the opening of bankruptcy proceedings, whether secured creditors are given priority for payments made with the proceeds of the security and how claims of secured creditors are ranked. As noted earlier, a substantial portion of the concessionaire's debt takes the form of "senior" loans, with the lenders requiring precedence of payment over payment of the subordinated debt of the concessionaire (see "Introduction and background information on privately financed infrastructure projects", para. 58). The extent to which the lenders will be able to enforce such subordination arrangements will depend on the rules and provisions of the laws of the country that govern the ranking of creditors in insolvency proceedings. The legal recognition of party autonomy on the establishment of contractual subordination of different classes of loans may facilitate the financing of infrastructure projects.

48. Among the issues that the legislation should address are the following: the question of the ranking of creditors; the relationship 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 concessionaire; and provisions on avoidance of transactions entered into by the debtor shortly before the opening of the insolvency proceedings.

49. In large infrastructure projects, the insolvency of the 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 be used by countries wishing to adopt legislation for that purpose is provided in the UNCITRAL Model Law on Cross-Border Insolvency.

14. Anti-corruption measures

50. The investment and business environment in the host country may also be enhanced by measures to fight corruption in the administration of government contracts. It is particularly important for the host country to take effective and concrete action to combat bribery and related illicit practices, in particular to pursue effective enforcement of existing laws prohibiting bribery.

51. The enactment of laws that incorporate international agreements and standards on integrity in the conduct of public business may represent a significant step in that direction. Important standards are contained in two resolutions of the United Nations General Assembly: resolution 51/59 of 12 December 1996, by which the Assembly adopted the International Code of Conduct for Public Officials, and resolution 51/191 of 16 December 1996, by which it adopted the United Nations Declaration against Corruption and Bribery in International Commercial Transactions. Other important instruments include the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions of 1997, which was negotiated under the auspices of the Organisation for Economic Cooperation and Development.

52. Furthermore, it is important that the rules covering the functioning of contracting authorities and the monitoring of public contracts ensure the required degree of transparency and integrity. Where such rules do not exist, appropriate legislation and regulations should be developed and adopted. Simplicity and consistency, coupled with the elimination of unnecessary procedures that prolong the administrative procedures or make them cumbersome, are additional elements to be taken into consideration in this context.

C. INTERNATIONAL AGREEMENTS

53. 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 discussed briefly below, in addition to other international agreements mentioned throughout the *Legislative Guide*.

1. Membership in multilateral financial institutions

54. Membership in multilateral financial institutions such as the World Bank, the International Development Association, the International Finance Corporation, the Multilateral Investment Guarantee Agency and the regional development banks may have a direct impact on privately financed infrastructure projects in various ways. Firstly, the host country's membership in those institutions is typically a requirement in order for projects in the host country to receive financing and guarantees provided by those institutions. Secondly, the rules on financing and guarantee instruments provided by those institutions typically contain a variety of terms and conditions of direct relevance for the terms of the project agreement and the loan agreements negotiated by the concessionaire (for example, a clause of negative pledge of public assets and provision of counter-guarantees in favour of the multilateral financial institution). Lastly, multilateral financial institutions usually follow a number of policy objectives whose implementation they seek to ensure in connection with projects supported by them (such as adherence to internationally acceptable environmental standards, long-term sustainability of the project beyond the initial concession period and transparency and integrity in the selection of the concessionaire and the disbursement of their loans).

2. General agreements on trade facilitation and promotion

55. 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 and later WTO. Those agreements may contain general provisions on trade promotion and facilitation of trade in goods (such as a most-favoured-nation clause or prohibition of the use of quantitative restrictions and other discriminatory trade barriers) and on the promotion of fair trade practices (such as prohibition of dumping and limita-

tions 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 that contemplates restrictions on the participation of foreign companies in infrastructure projects or establishes preferences for national entities or for the procurement of supplies on the local market.

3. International agreements on specific industries

56. In the context of the negotiations on basic telecommunications concluded as part of the General Agreement on Trade in Services (GATS), a number of States members of WTO representing most of the world market for telecommunication services have made specific commitments to facilitate trade in telecommunication services. It should be noted that all WTO member States (even those which have not made specific telecommunication 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 telecommunication 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 should thus ensure that the country's telecommunication laws are consistent with the GATS agreement and their specific telecommunication commitments.

57. 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 for various commercial measures, such as the development of open and competitive markets for energy materials and products and the facilitation of transit and 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 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 due to war, civil disturbance or other similar events and compensation for expropriation.

A/CN.9/471/Add.9

CONSOLIDATED LEGISLATIVE RECOMMENDATIONS

CONTENTS

FOREWORD

Each chapter of the *Guide* contains a set of recommended legislative principles entitled "Legislative Recommendations". The Legislative Recommendations are intended to assist in the establishment of a legislative framework favourable to privately financed infrastructure projects. The Legislative Recommendations contained in the *Guide* are followed by notes which offer an analytical introduction with references to financial, regulatory, legal, policy, and other issues raised in the subject area. The full text of all Legislative Recommendations contained in the *Guide* is reproduced hereafter for ease of reference. The user is advised to read the Legislative Recommendations together with the notes, which provide background information to enhance the understanding of the Legislative Recommendations.

The Legislative Recommendations deal with matters that are important to address in legislation specifically concerned with privately financed infrastructure projects. They do not deal with other areas of law which, as discussed in notes to the Legislative Recommendations, also have an impact on privately financed infrastructure projects. Moreover, the successful implementation of privately financed infrastructure projects typically requires various measures beyond the establishment of an appropriate legislative framework, such as adequate administrative structures and practices, organizational capability, technical expertise, appropriate human and financial resources, and economic stability.

For host countries wishing to promote privately financed infrastructure projects it is recommended that the following principles should be implemented by the law:

I. GENERAL LEGISLATIVE AND INSTITUTIONAL FRAMEWORK

Constitutional and legislative framework (see chap. I, "General legislative and institutional framework", paras. 2-14)

Recommendation 1. The legislative and institutional framework for the implementation of privately financed infrastructure projects should ensure transparency, fairness, and the long-term sustainability of projects. Undesirable restrictions to private sector participation in infrastructure development and operation should be eliminated.

Scope of authority to award concessions (see chap. I, "General legislative and institutional framework", paras. 15-22)

Recommendation 2. The law should identify the public authorities of the host country (including, as appropriate, national, provincial and local authorities) which are empowered to enter into agreements for the implementation of privately financed infrastructure projects.

Recommendation 3. Privately financed infrastructure projects may include concessions for the construction and operation of new infrastructure facilities and systems or the maintenance, modernization, expansion and operation of existing infrastructure facilities and systems.

Recommendation 4. The law should identify the sectors or types of infrastructure in respect of which concessions may be granted.

Recommendation 5. The law should specify the extent to which a concession might extend to the entire region under the jurisdiction of the respective contracting authority, to a geographical subdivision thereof or to a discrete project, and whether it might be awarded with or without exclusivity, as appropriate, in accordance with rules and principles of law, statutory provisions, regulations and policies applying to the sector concerned. Contracting authorities might be jointly empowered to award concessions beyond a single jurisdiction.

Administrative coordination (see chap. I, "General legislative and institutional framework", paras. 23-29)

Recommendation 6. Institutional mechanisms should be established to coordinate the activities of the public authorities responsible for issuing approvals, licences, permits or authorizations required for the implementation of privately financed infrastructure projects in accordance with statutory or regulatory provisions on the construction and operation of infrastructure facilities of the type concerned.

Authority to regulate infrastructure services (see chap. I, "General legislative and institutional framework", paras. 30-53)

Recommendation 7. The authority to regulate infrastructure services should not be entrusted to entities which directly or indirectly provide infrastructure services.

Recommendation 8. Regulatory competence should be entrusted to functionally independent bodies with a sufficient level of autonomy to ensure that their decisions are taken without political interference or inappropriate pressures from infrastructure operators and public service providers.

Recommendation 9. The rules governing regulatory procedures should be published. Regulatory decisions should state the reasons on which they are based and be accessible to interested parties through publication or other means.

Recommendation 10. The law should establish transparent procedures whereby the concessionaire may request a review of regulatory decisions by an independent and impartial body and set forth the grounds on which a request for review may be based and the availability of court review.

Recommendation 11. Where appropriate, special procedures should be established for handling disputes among public service providers concerning alleged violations of laws and regulations governing the relevant sector.

II. PROJECT RISKS AND GOVERNMENT SUPPORT

Project risks and risk allocation (see chap. II, "Project risks and government support", paras. 8-29)

Recommendation 12. No unnecessary statutory or regulatory limitations should be placed upon the contracting authority's ability to agree on an allocation of risks that is suited to the needs of the project.

Government support (see chap. II, "Project risks and government support", paras. 30-60)

Recommendation 13. The law should clearly state which public authorities of the host country may provide financial or economic support to the implementation of privately financed infrastructure projects and which types of support they are authorized to provide.

III. SELECTION OF THE CONCESSIONAIRE

General considerations (see chap. III, "Selection of the concessionaire", paras. 1-33)

Recommendation 14. The law should provide for the selection of the concessionaire through transparent and ef-

ficient competitive procedures adapted to the particular needs of privately financed infrastructure projects.

Pre-selection of bidders (see chap. III, "Selection of the concessionaire", paras. 34-50)

Recommendation 15. The bidders should demonstrate that they meet the preselection criteria which the contracting authority considers appropriate for the particular project, including:

(a) Adequate professional and technical qualifications, human resources, equipment and other physical facilities, as necessary to carry out all the phases of the project, namely engineering, construction, operation and maintenance;

(b) Sufficient ability to manage the financial aspects of the project and capability to sustain the financing requirements for the engineering, construction and operational phases of the project;

(c) Appropriate managerial and organizational capability, reliability and experience, including previous experience in operating public infrastructure.

Recommendation 16. The bidders should be allowed to form consortia to submit proposals, provided that each member of a preselected consortium may participate, either directly or through subsidiary companies, in only one bidding consortium.

Recommendation 17. The contracting authority should elaborate a short list of the preselected bidders which will be subsequently invited to submit proposals upon completion of the preselection phase.

Procedure for requesting proposals (see chap. III, "Selection of the concessionaire", paras. 51-84)

Single-stage and two-stage procedure for requesting proposals

Recommendation 18. Upon completion of the preselection proceedings, the contracting authority should invite the preselected bidders to submit final proposals.

Recommendation 19. Notwithstanding the above, the contracting authority may use a two-stage procedure to request proposals from preselected bidders when it is not feasible for the contracting authority to formulate project specifications or performance indicators and contractual terms in a manner sufficiently detailed and precise to permit final proposals to be formulated. Where a two-stage procedure is used, the following provisions apply:

(a) The contracting authority should first call upon the preselected bidders to submit proposals relating to output specifications and other characteristics of the project as well as to the proposed contractual terms;

(b) The contracting authority may convene a meeting of bidders to clarify questions concerning the initial request for proposals;

(c) Following examination of the proposals received, the contracting authority may review and, as appropriate, revise the initial project specifications and contractual terms prior to issuing a final request for proposals.

Content of the final request for proposals

Recommendation 20. The final request for proposals should include at least the following:

(a) General information as may be required by the bidders in order to prepare and submit their proposals;

(b) Project specifications and performance indicators, as appropriate, including the contracting authority's requirements regarding safety and security standards and environmental protection;

(c) The contractual terms proposed by the contracting authority;

(d) The criteria for evaluating the proposals, the relative weight to be accorded to each such criterion and the manner in which they are to be applied in the evaluation of proposals.

Clarifications and modifications

Recommendation 21. The contracting authority may, whether on its own initiative or as a result of a request for clarification by a bidder, modify the final request for proposals by issuing addenda at a reasonable time prior to the deadline for submission of proposals.

Evaluation criteria

Recommendation 22. The criteria for the evaluation and comparison of the technical proposals should concern the effectiveness of the proposal submitted by the bidder in meeting the needs of the contracting authority, including the following:

(a) Technical soundness;

(b) Operational feasibility;

(c) Quality of services and measures to ensure their continuity;

(d) Social and economic-development potential offered by the proposals.

Recommendation 23. The criteria for the evaluation and comparison of the financial and commercial proposals may include, as appropriate:

(a) The present value of the proposed tolls, fees, and other charges over the concession period;

(b) The present value of the proposed direct payments by the contracting authority, if any;

(c) The costs for design and construction activities, annual operation and maintenance costs, present value of capital costs and operating and maintenance costs;

(d) The extent of financial support, if any, expected from the Government;

(e) Soundness of the proposed financial arrangements;

(f) The extent of acceptance of the proposed contractual terms.

Submission, opening, comparison and evaluation of proposals

Recommendation 24. The contracting authority may establish thresholds with respect to quality, technical and commercial aspects to be reflected in the proposals in accordance with the criteria as set out in the request for proposals. Proposals which fail to achieve the thresholds should be regarded as non-responsive.

Recommendation 25. Whether or not it has used preselection proceedings the contracting authority may retain the right to require the bidders to demonstrate again their qualifications in accordance with criteria and procedures set forth in the request for proposals or the preselection documents, as appropriate. Where preselection proceedings have been used, the criteria shall be the same as those used in the preselection proceedings.

Final negotiations

Recommendation 26. The contracting authority should rank all responsive proposals on the basis of the evaluation criteria set forth in the request for proposals and invite for final negotiation of the project agreement the bidder that has attained the best rating. Final negotiations may not concern those terms of the contract that were stated as non-negotiable in the final request for proposals.

Recommendation 27. If it becomes apparent to the awarding authority that the negotiations with the bidder invited will not result in a project agreement, the awarding authority should inform that bidder that it is terminating the negotiations and then invite for negotiations the other bidders on the basis of their ranking until it arrives at a project agreement or rejects all remaining proposals.

Direct negotiations (see chap. III, "Selection of the concessionaire", paras. 85-96)

Recommendation 28. The law should set forth the exceptional circumstances under which the contracting authority may be authorized by a higher authority to select the concessionaire through direct negotiations, such as:

(a) When there is an urgent need for ensuring continuity in the provision of the service, and engaging in a competitive selection procedure would therefore be impractical;

(b) In case of projects of short duration and with an anticipated initial investment value not exceeding a specified low amount;

(c) Reasons of national defence or national security;

(d) Cases where there is only one source capable of providing the required service (e.g. because it requires the use of patented technology or unique know-how);

(e) When an invitation to the preselection proceedings or a request for proposals has been issued but no applications or proposals were submitted or all proposals failed to meet the evaluation criteria set forth in the request for proposals, and in the judgement of the contracting authority issuing a new request for proposals would be unlikely to result in a project award;

(f) Other cases where the higher authority authorizes such an exception for compelling reasons of public interest.

Recommendation 29. The law may require that the following procedures be observed in direct negotiations:

(a) The contracting authority should publish a notice of the negotiation proceedings and engage in negotiations with as many companies judged capable of carrying out the project as circumstances permit;

(b) The contracting authority should establish and make known to bidders the qualification criteria and the criteria for evaluating the proposals and 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 the proposals;

(c) The contracting authority should treat proposals in a manner which avoids the disclosure of their contents to competing bidders;

(d) Any such negotiations between the contracting authority and bidders should be confidential and one party to the negotiations should not reveal to any other person any technical, price or other commercial information relating to the negotiations without the consent of the other party;

(e) Following completion of negotiations, the contracting authority should request all bidders remaining in the proceedings to submit, by a specified date, a best and final offer with respect to all aspects of their proposals;

(f) Proposals should be evaluated and ranked according to the criteria for the evaluation of proposals established by the contracting authority.

Unsolicited proposals (see chap. III, "Selection of the concessionaire", paras. 97-117)

Recommendation 30. By way of exception to the selection procedures described in legislative recommendations 12 to 25, the contracting authority may be authorized to handle unsolicited proposals pursuant to specific procedures established by the law for handling unsolicited proposals, provided that such proposals should not relate to a project for which selection procedures have been initiated or announced by the contracting authority.

Procedures for determining the admissibility of unsolicited proposals

Recommendation 31. Following receipt and preliminary examination of an unsolicited proposal, the contract-

ing authority should inform the proponent, within a reasonably short period, whether or not there is a potential public interest in the project. If the project is found to be in the public interest, the contracting authority should invite the proponent to submit a formal proposal in sufficient detail to allow the contracting authority to properly evaluate the concept or technology and determine whether the proposal meets the conditions set forth in the law and is likely to be successfully implemented at the scale of the proposed project.

Recommendation 32. The proponent 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.

Procedures for handling unsolicited proposals that do not involve proprietary concepts or technology

Recommendation 33. The contracting authority should initiate competitive selection procedures under recommendations 12 to 25 above if it is found that the envisaged output of the project can be achieved without the use of a process, design, methodology or engineering concept for which the author of the unsolicited proposal possesses exclusive rights or if the proposed concept or technology is not truly unique or new. The author of the unsolicited proposal should be invited to participate in such proceedings and might be given a premium for submitting the proposal.

Procedures for handling unsolicited proposals involving proprietary concepts or technology

Recommendation 34. If it appears that the envisaged output of the project cannot be achieved without using a process, design, methodology or engineering concept for which the author of the unsolicited proposal possesses exclusive rights, the contracting authority should seek to obtain elements of comparison for the unsolicited proposal. For that purpose, the contracting authority should publish a description of the essential output elements of the proposal with an invitation for other interested parties to submit alternative or comparable proposals within a certain reasonable period.

Recommendation 35. The contracting authority may engage in negotiations with the author of the unsolicited proposal if no alternative proposals are received, subject to approval by a higher authority. If alternative proposals are submitted, the contracting authority should invite all the proponents to negotiations in accordance with the provisions of legislative recommendation 28 *(b)* to *(f)*.

Review procedures (see chap. III, "Selection of the concessionaire", paras. 118-122)

Recommendation 36. Bidders who claim to have suffered, or who may suffer, loss or injury due to a breach of a duty imposed on the contracting authority by the law may seek review of the contracting authority's acts in accordance with the laws of the host country.

Notice of project award (see chap. III, "Selection of the concessionaire", para. 123)

Recommendation 37. The contracting authority should cause a notice of the award of the project to be published. The notice should identify the concessionaire and include a summary of the essential terms of the project agreement.

Record of selection and award proceedings (see chap. III, "Selection of the concessionaire", paras. 124-130)

Recommendation 38. The contracting authority should keep an appropriate record of key information pertaining to the selection and award proceedings. The law should set forth the public access requirements.

IV. CONSTRUCTION AND OPERATION OF INFRASTRUCTURE

General provisions on the project agreement (see chap. IV, "Construction and operation of infrastructure", paras. 1-11)

Recommendation 39. The law might identify the core terms to be provided in the project agreement which may include those terms referred to in recommendations 39 to 65 below.

Recommendation 40. Unless otherwise provided, the project agreement is governed by the law of the host country.

Organization of the concessionaire (see chap. IV, "Construction and operation of infrastructure", paras. 12-18)

Recommendation 41. The contracting authority should have the option to require that the selected bidders establish an independent legal entity with a seat in the country.

Recommendation 42. The project agreement should specify the minimum capital of the project company and the procedures for obtaining the approval of the contracting authority to its statutes and by-laws of the project company and fundamental changes therein.

The project site and easements (see chap. IV, "Construction and operation of infrastructure", paras. 19-32)

Recommendation 43. The project agreement should specify, as appropriate, which assets will be public property and which assets will be the private property of the concessionaire. The project agreement should identify which assets the concessionaire is required to transfer to the contracting authority or to a new concessionaire upon expiry or termination of the project agreement; which assets the contracting authority, at its option, may purchase from the

concessionaire; and which assets the concessionaire may freely remove or dispose of upon expiry or termination of the project agreement.

Recommendation 44. The contracting authority should assist the concessionaire in the acquisition of easements needed for the operation, construction and maintenance of the facility. The law might empower the concessionaire to enter upon, transit through, do work or fix installations upon, property of third parties, as required for the construction and operation of the facility.

Financial arrangements (see chap. IV, "Construction and operation of infrastructure", paras. 33-51)

Recommendation 45. The law should enable the concessionaire to collect tariffs or user fees for the use of the facility or the services it provides. The project agreement should provide for methods and formulas for the adjustment of those tariffs or user fees.

Recommendation 46. Where the tariffs or fees charged by the concessionaire are subject to external control by a regulatory body, the law should set forth the mechanisms for periodic and extraordinary revisions of the tariff adjustment formulas.

Recommendation 47. The contracting authority should have the power, where appropriate, to agree to make direct payments to the concessionaire as a substitute for, or in addition to, service charges to be paid by the users or to enter into commitments for the purchase of fixed quantities of goods or services.

Security interests (see chap. IV, "Construction and operation of infrastructure", paras. 52-61)

Recommendation 48. The concessionaire should be responsible for raising the funds required to construct and operate the infrastructure facility and, for that purpose, should have the right to secure any financing required for the project with a security interest in any of its property, with a pledge of shares of the project company, with a pledge of the proceeds and receivables arising out of the concession, or with other suitable security, without prejudice to any rule of law that might prohibit the creation of security interests in public property in the possession of the concessionaire.

Assignment of the concession (see chap. IV, "Construction and operation of infrastructure", paras. 62-63)

Recommendation 49. The project agreement should set forth the conditions under which the contracting authority might give its consent to an assignment of the concession, including the acceptance by the new concessionaire of all obligations under the project agreement and evidence of the new concessionaire's technical and financial capability as necessary for providing the service. The concession should not be assigned to third parties without the consent of the contracting authority .

Transfer of controlling interest in the project company (see chap. IV, "Construction and operation of infrastructure", paras. 64-68)

Recommendation 50. The transfer of a controlling interest in the capital of a concessionaire company may require the consent of the contracting authority.

Construction works (see chap. IV, "Construction and operation of infrastructure", paras. 69-79)

Recommendation 51. The project agreement should set forth the procedures for the review and approval of construction plans and specifications by the contracting authority, the contracting authority's right to monitor the construction of, or improvements to, the infrastructure facility, the conditions under which the contracting authority may order variations in respect of construction specifications and the procedures for testing and final inspection, approval and acceptance of the facility, its equipment and appurtenances.

Infrastructure operation (see chap. IV, "Construction and operation of infrastructure", paras. 80-97)

Recommendation 52. The project agreement should set forth, as appropriate, the extent of the concessionaire's obligations to ensure:

(a) The adaptation of the service so as to meet the actual demand for the service;

(b) The continuity of the service;

(c) The availability of the service under essentially the same conditions to all users;

(d) The non-discriminatory access, as appropriate, of other service providers to any public infrastructure network operated by the concessionaire.

Recommendation 53. The project agreement should set forth:

(a) The extent of the concessionaire's obligation to provide the contracting authority or a regulatory body, as appropriate, with reports and other information on its operations;

(b) The procedures for monitoring the concessionaire's performance and for taking such reasonable actions as the contracting authority or a regulatory body may find appropriate, to ensure that the infrastructure facility is properly operated and the services are provided in accordance with the applicable legal and contractual requirements.

Recommendation 54. The concessionaire should have the right to issue and enforce rules governing the use of the facility, subject to the approval of the contracting authority or a regulatory body.

General contractual arrangements (see chap. IV, "Construction and operation of infrastructure", paras. 98-150)

Recommendation 55. The contracting authority may reserve the right to review and approve major contracts to be entered into by the concessionaire, in particular contracts with the concessionaire's own shareholders or related persons. The contracting authority's approval should not normally be withheld except where the contracts contain provisions inconsistent with the project agreement or manifestly contrary to the public interest or to mandatory rules of a public law nature.

Recommendation 56. The concessionaire and its lenders, insurers and other contracting partners should be free to choose the law applicable to govern their contractual relations, except where such a choice would violate the host country's public policy.

Recommendation 57. The project agreement should set forth:

(a) The forms, duration and amounts of the guarantees of performance that the concessionaire may be required to provide in connection with the construction and the operation of the facility;

(b) The insurance policies that the concessionaire may be required to maintain;

(c) The compensation to which the concessionaire may be entitled following the occurrence of legislative changes or other changes in the economic or financial conditions that render the performance of the obligation substantially more onerous than originally foreseen. The project agreement should further provide mechanisms for revising the terms of the project agreement following the occurrence of any such changes;

(d) The extent to which either party may be exempt from liability for failure or delay in complying with any obligation under the project agreement due to circumstances beyond their reasonable control;

(e) Remedies available to the contracting authority and the concessionaire in the event of default by the other party.

Recommendation 58. The project agreement should set forth the circumstances under which the contracting authority may temporarily take over the operation of the facility for the purpose of ensuring the effective and uninterrupted delivery of the service in the event of serious failure by the concessionaire to perform its obligations.

Recommendation 59. The contracting authority should be authorized to enter into agreements with the lenders providing for the appointment, with the consent of the contracting authority, of a new concessionaire to perform under the existing project agreement if the concessionaire seriously fails to deliver the service required or if other specified events occur that could justify the termination of the project agreement.

V. DURATION, EXTENSION AND TERMINATION OF THE PROJECT AGREEMENT

Duration and extension of the project agreement (see chap. V, "Duration, extension and termination of the project agreement", paras. ___)

Recommendation 60. The duration of the concession should be specified in the project agreement.

Recommendation 61. The term of the concession should not be extended, except for those circumstances specified in the law, such as:

(a) Completion delay or interruption of operation due to the occurrence of circumstances beyond either party's reasonable control;

(b) Project suspension brought about by acts of the contracting authority or other public authorities;

(c) To allow the concessionaire to recover additional costs arising from requirements of the contracting authority not originally foreseen in the project agreement which the concessionaire would not be able to recover during the normal term of the project agreement.

Termination of the project agreement (see chap. V, "Duration, extension and termination of the project agreement", paras. ___)

Termination by the contracting authority

Recommendation 62. The contracting authority should have the right to terminate the project agreement:

(a) In the event that it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations, due to insolvency, serious default or otherwise;

(b) For reasons of public interest, subject to payment of compensation to the concessionaire.

Termination by the concessionaire

Recommendation 63. The concessionaire should have the right to terminate the project agreement under exceptional circumstances specified in the law, such as:

(a) In the event of serious default by the contracting authority or other public authority as regards the fulfilment of their obligations under the project agreement;

(b) In the event that the concessionaire's performance is rendered substantially more onerous as a result of variation orders or other acts of the contracting authority, unforeseen changes in conditions or acts of other public authorities and that the parties have failed to agree on an appropriate revision of the project agreement.

Termination by either party

Recommendation 64. Either party should have the right to terminate the project agreement in the event that the performance of its obligations is rendered impossible by the occurrence of circumstances beyond either party's reasonable control. The parties should further have the right to terminate the project agreement by mutual consent.

Consequences of expiry or termination of the project agreement (see chap. V, "Duration, extension and termination of the project agreement", paras. ___)

Transfer of assets to the contracting authority or to a new concessionaire

Recommendation 65. The project agreement should lay down the criteria for establishing, as appropriate, the compensation to which the concessionaire may be entitled in respect of assets transferred to the contracting authority or to a new concessionaire or purchased by the contracting authority upon expiry or termination of the project agreement.

Financial arrangements upon termination

Recommendation 66. The project agreement should stipulate how compensation due to either party in the event of termination of the project agreement is to be calculated, providing, where appropriate, for compensation for the fair value of works performed under the project agreement, and for losses, including lost profits.

Wind-up and transfer measures

Recommendation 67. The project agreement should set out, as appropriate, the rights and obligations of the parties with respect to:

(a) The transfer of technology required for the operation of the facility;

(b) The training of the contracting authority's personnel or of a successor concessionaire in the operation and maintenance of the facility;

(c) The provision, by the concessionaire, of operation and maintenance services and the supply of spare parts, if required, for a reasonable period after the transfer of the facility to the contracting authority or to a successor concessionaire.

VI. SETTLEMENT OF DISPUTES

Disputes between the contracting authority and the concessionaire (see chap. VI, "Settlement of disputes", paras. ___)

Recommendation 68. The contracting authority should be free to agree to dispute settlement mechanisms regarded by the parties as suited to the needs of the project, including arbitration.

[*Recommendation 68*bis. The law should indicate whether, and, if so, to what extent the contracting authority may raise a plea of sovereign immunity, both as a bar to the commencement of arbitral or judicial proceedings as well as a defence against enforcement of the award or judgement.]

Disputes between the concessionaire and its lenders, contractors and suppliers (see chap. VI, "Settlement of disputes", paras. ___)

Recommendation 69. The concessionaire should be free to choose the appropriate mechanisms for settling commercial disputes among the project sponsors, or disputes between the concessionaire and its lenders, contractors, suppliers and other business partners.

Disputes between the concessionaire and its customers (see chap. VI, "Settlement of disputes", paras. ___)

Recommendation 70. The concessionaire may be required to make available simplified and efficient mechanisms for handling claims submitted by its customers or users of the infrastructure facility.

II. ASSIGNMENT IN RECEIVABLES FINANCING

A. Report of the Working Group on International Contract Practices on the work of its thirty-first session

(Vienna, 11-22 October 1999 (A/CN.9/466) [Original: English]

CONTENTS

*Only articles and issues discussed at this session are listed in this report. With the exception of the proposal with regard to the issue of location of the parties, issues are listed in the order they were discussed. The annex to this report contains the consolidated text of the draft Convention and the annex to the draft Convention as a whole, as adopted by the Working Group.

I. INTRODUCTION

1. At the present 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] This was the eighth session devoted to the preparation of this 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 (1980) had decided to defer for a later stage.

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 financ-

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

ing 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.[2]

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.[3]

6. At its twenty-fifth and twenty-sixth sessions (New York, 8-19 July and Vienna, 11-22 November 1996 respectively), the Working Group continued its work by considering different versions of the draft uniform rules contained in two notes prepared by the secretariat (A/CN.9/WG.II/WP.87 and A/CN.9/WG.II/WP.89 respectively). 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).

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] 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.[5]

8. At its twenty-seventh and twenty-eighth sessions (Vienna, 20-31 October 1997 and New York, 2-13 March 1998 respectively), the Working Group considered two notes prepared by the secretariat (A/CN.9/WG.II/WP.93 and A/CN.9/WG.II/WP.96 respectively). At its twenty-seventh session, the Working Group had decided that basic priority rules of the draft Convention would be private international law rules and the substantive law priority rules of the draft Convention would be subject to an opt-in by States (A/CN.9/445, paras. 26-27), while, at its twenty-eighth session, the Working Group had adopted the substance of draft articles 14 to 16, dealing with the relationship between the assignor and the assignee, and 18 to 22, dealing with the relationship between the assignee and the debtor (A/CN.9/447, paras. 161-164).

9. At its thirty-first session (1998), the Commission had before it the report of the twenty-seventh and twenty-eighth sessions of the Working Group (A/CN.9/445 and A/CN.9/447). The Commission expressed appreciation for the work accomplished and requested the Working Group to proceed with its work expeditiously so as to complete its work in 1999 and submit the draft Convention for adoption by the Commission at its thirty-third session (2000).[6]

10. At its twenty-ninth and thirtieth sessions (Vienna, 5-16 October 1998 and New York, 1-12 March 1999 respectively), the Working Group considered three notes prepared by the secretariat (A/CN.9/WG.II/WP.96, A/CN.9/WG.II/WP.98 and A/CN.9/WG.II/WP.102), as well as a note containing the report of a group of experts prepared by the Permanent Bureau of the Hague Conference on Private International Law (A/CN.9/WG.II/WP.99). At those sessions, the Working Group adopted the substance of the preamble and draft articles 1(1) and (2), 5 *(g)* to *(j)*, 18 (5*bis*), 23 to 33 and 41 to 50 (A/CN.9/455, para. 17) and the title, the preamble and draft articles 1 to 24 (A/CN.9/456, para. 18).

11. At its thirty-second session (1999), the Commission had before it the report of the twenty-ninth and thirtieth sessions of the Working Group (A/CN.9/455 and A/CN.9/456). The Commission expressed appreciation for the work accomplished by the Working Group and requested the Working Group to proceed with its work expeditiously so as to make it possible for the draft Convention, along with the report of the next session of the Working Group, to be circulated to Governments for comments in good time and for the draft Convention to be considered by the Commission for adoption at its thirty-third session (2000). As regards the subsequent procedure for adopting the draft Convention, the Commission noted that it would have to decide at its next session whether it should recommend adoption by the General Assembly or by a diplomatic conference to be specially convened by the General Assembly for that purpose.[7]

12. The Working Group, which was composed of all States members of the Commission, held the present session at Vienna from 11 to 22 October 1999. The session was attended by representatives of the following States members of the Working Group: Algeria, Australia, Austria, Bulgaria, Cameroon, China, Colombia, Egypt, Finland, France, Germany, Honduras, Hungary, Iran (Islamic Republic of), Italy, Japan, Lithuania, Mexico, Nigeria, Romania, Russian Federation, Singapore, Spain, Thailand, United Kingdom of Great Britain and Northern Ireland, United States of America and Uruguay.

13. The session was attended by observers from the following States: Benin, Bolivia, Cambodia, Canada, Congo, Czech Republic, Gabon, Georgia, Greece, Guatemala, Indonesia, Iraq, Ireland, Lebanon, Libyan Arab Jamahiriya, Namibia, Netherlands, Poland, Republic of Korea, Saudi Arabia, Slovakia, Sweden, Switzerland, Tunisia and Turkey.

[2] *Official Records of the General Assembly, Forty-eighth Session, Supplement No. 17* (A/48/17), paras. 297-301; *Official Records of the General Assembly, Forty-ninth Session, Supplement No. 17* (A/49/17), paras. 208-214; and *Official Records of the General Assembly, Fiftieth Session, Supplement No. 17* (A/50/17), paras. 374-381.

[3] Ibid., *Fifty-first Session, Supplement No. 17* (A/51/17), para. 234.

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

[5] Ibid., para. 256.

[6] Ibid., *Fifty-third Session, Supplement No. 17* (A/53/17), para. 230.

[7] Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), para. 330.

14. The session was attended by observers from the following international organizations: Association of the Bar of the City of New York (ABCNY), Commercial Finance Association (CFA), European Federation of National Factoring Associations (EUROPAFACTORING), Factors Chain International (FCI), Fédération bancaire de l'Union européenne, *Federacion Latinoamericana de Bancos* (FELABAN) and International Institute for the Unification of Private Law (Unidroit).

15. The Working Group elected the following officers:

Chairman: Mr. David MORÁN BOVIO (Spain)

Rapporteur: Ms. Victoria GAVRILESCU (Romania)

16. The Working Group had before it the following documents: the provisional agenda (A/CN.9/WG.II/WP.103), a note by the secretariat entitled "Draft Convention on Assignment in Receivables Financing: text with remarks and suggestions" (A/CN.9/WG.II/WP.104), and two other notes by the secretariat entitled "Commentary to the draft Convention on Assignment in Receivables Financing" (A/CN.9/WG.II/WP.105 and 106).

17. 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

18. The Working Group considered pending issues identified in the text of the draft Convention with language in square brackets or in the remarks of the secretariat (A/CN.9/WG.II/WP.104). Noting that the provisions of the draft Convention dealing with conflicts of priority had not been sufficiently discussed at the previous session, the Working Group decided to begin its deliberations with draft articles 23 to 26 and to consider in that context the issue of "location". Also noting the importance of scope and exclusions, before continuing in the numerical order of the draft articles, the Working Group addressed exclusions in draft article 4.

19. The deliberations and conclusions of the Working Group, including its consideration of various draft provisions, are set forth below in chapters III to VII. The Working Group considered draft articles 1 (3), 2 to 5, 8, 10 to 12, 16, 19 to 29 and 33 to 42 of the draft Convention, as well as draft articles 1 to 7 of the annex to the draft Convention. With the exception of the wording within square brackets which was referred to the Commission, the Working Group adopted the draft Convention and the annex thereto as a whole. Having completed its work, the Working Group decided to submit the draft Convention to the Commission for adoption at its thirty-third session (New York, 12 June to 7 July 2000).

III. DRAFT CONVENTION ON ASSIGNMENT [IN RECEIVABLES FINANCING] [OF RECEIVABLES IN INTERNATIONAL TRADE]

Article 24. *Competing rights of several assignees*

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

"(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) An assignee entitled to priority may at any time subordinate unilaterally or by agreement its priority in favour of any existing or future assignees."

21. In order to avoid leaving to the law of the assignor's location issues that were intended to be covered by the draft Convention (e.g. the question whether an assignee may give a notification with regard to future receivables so as to obtain priority under the law of the assignor's location), the Working Group decided to include at the beginning of paragraph (1) language along the opening words of draft article 27 (1): "With the exception of matters which are settled in this Convention".

22. Confirming its understanding that paragraph (1) applied to a conflict of priority between a foreign and a domestic assignee of the same domestic receivables from the same assignor (A/CN.9/445, para. 22), the Working Group decided to include at the end of paragraph (1) language along the following lines: "This rule applies even if one of the assignees is an assignee in a domestic assignment of domestic receivables".

23. The question was raised as to whether a conflict with an inventory financier or a supplier of goods with a retention of title, who had a right in the proceeds from the sale of the inventory or the goods, would be covered by draft article 24. In response, it was observed that the reference in draft article 25 (1) to "the assignor's creditors" was sufficient to encompass conflicts with inventory financiers and suppliers of goods on credit. In any case, it was stated, if the right of such persons in the proceeds was contractual, they should be treated as assignees.

24. After discussion, the Working Group adopted draft article 24 as amended and referred it to the drafting group.

"Location" of the parties

25. In the context of its discussion of draft article 24, the Working Group considered the meaning of the term "location" (defined in draft article 5 *(j)* and *(k)*). The Working Group based its discussion on a draft prepared by the secretariat, which was as follows:

"(i) a party is located in the State in which it has its place of business;

"(ii) if the assignor or the assignee have more than one place of business, the place of business is that which has the closest relationship to the contract of assignment. If the debtor has more than one place of business, the place of business is that which has the closest relationship to

the original contract. If a party does not have a place of business, reference is to be made to the habitual residence of that party;

"(iii) for the purposes of articles 24 to 26, the place where the central administration of an entity is exercised de facto is deemed to be the place of business with the closest relationship to the contract of assignment[;

"(iv) several assignors or assignees are located at the place in which their authorized agent or trustee is located]."

26. It was noted that that text was an attempt to build on the common points that emerged from the discussion at the previous session of the Working Group. Those points were: that the need for certainty was much stronger in the priority provisions than in the scope provisions; that the scope of application of the draft Convention should be as broad as possible; that, in order to achieve a sufficient degree of debtor-protection, at least, with regard to the debtor's location, reference should be made to the relevant place of business; and that a solution with regard to the priority provisions could be built around the concept of central administration/chief executive office of an entity (A/CN.9/456, paras. 35-37).

27. Support was expressed in favour of the above-mentioned text. However, the concern was expressed that the application of two different location rules could lead to inconsistent results. The concern was also expressed that adoption of a central-administration test would result in priority conflicts involving branch offices being inappropriately subjected to the law of the location of the head office, even if that jurisdiction had nothing to do with the transactions that gave rise to such conflicts. In order to address those concerns, a number of suggestions were made. One suggestion was that a more flexible rule along the lines of draft article 5 *(k)* (iv) should be established, allowing parties to prove that the place of central administration was not the place most closely connected to the relevant transaction. That suggestion was objected to on the ground that such a rule would introduce an unacceptable degree of uncertainty.

28. Another suggestion was to devise a rule along the lines of the above-mentioned text with an exception for branch offices of banks. In support of that suggestion, it was observed that, although branch offices had no separate legal personality from that of the head office, they were subject to the financial services regulations of the country in which they were located in respect of their activities in that country. It was also stated that the exception referred only to branch offices of banks, since it was normal practice for banks to operate through branch offices, while other industries operated more through subsidiaries, which were separate legal persons even if they operated under the instructions of the parent company. While that suggestion was met with interest, the view was expressed that there was no reason to limit the exception to branch offices of banks. It was also said that the formulation of such a limited exception would be a very difficult task since there was no universally acceptable definition of the term "bank". It was, therefore, suggested that the exception should apply to branch offices in general. That suggestion was objected to on the ground that such an exception would undermine the certainty achieved by a central administration-based rule, since third parties would need to do a factual search to establish which branch office a transaction was most closely connected to. It was stated that problems might arise from a double assignment of the same receivables by the head office and a branch office. It was also observed that a solution along the lines of the above-mentioned text, offering two different location rules, would be preferable to one rule with a broad exception for branch offices in general.

29. In the discussion, it was agreed that subparagraph (iv) of the above-mentioned text should be deleted. It was observed that assignments by multiple assignors were rare in practice and, in any case, the application of the draft Convention only to the assignment of an interest in receivables, which fell within the ambit of the draft Convention under chapter I, was an appropriate result. As to assignments to multiple assignees, it was stated that such assignments were part of well-developed practices in which parties normally settled the matter of location in their agreements. It was also agreed that the reference to a "de facto" central administration, contained in subparagraph (iii), was superfluous and could be deleted on the understanding that the actual place of central administration was meant. It was observed that use of the words "de facto" could inadvertently raise interpretation questions as to whether there was another "de jure" central administration (i.e. one artificially designated in the constitutive or other documents of a legal entity). It was also stated that the words "is exercised", which were intended to reflect a fact, were sufficient in clarifying that the actual place of central administration was meant.

30. After discussion, the Working Group decided that, for the continuation of the discussion, two alternatives should be included in the text of draft article 5 with regard to the definition of the term "location", one alternative along the lines of the text mentioned in paragraph 25 above and another that would read along the following lines:

"A person is located in the State in which it has its place of business. If an assignor or assignee has more than one place of business, it is located in the State in which it has its central administration. If a debtor has more than one place of business, it is located in the State in which it has that place of business which has the closest relationship to the original contract. [A branch of a person [engaged in the business of accepting deposits or providing other banking services] is deemed to be a separate person.] If a person does not have a place of business, it is located in the State of its habitual residence."

The Working Group left the specific formulation of those alternatives to the drafting group (for the continuation of the discussion on "location", see paras. 96-100).

Renvoi

31. In order to avoid the risk of renvoi (i.e. the application of the law designated by the private international law provisions—conflict of laws—of a State other than the forum State), the Working Group decided to include in draft article 5 a new subparagraph along the following lines: "'law' means the law in force in a State other than its rules of private international law".

Article 25. *Competing rights of assignee and creditors of the assignor or insolvency administrator*

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

"(1) Priority between an assignee and the assignor's creditors is governed by the law of the State in which the assignor is located.

"(2) In an insolvency proceeding, priority between the assignee and the assignor's creditors is governed by the law of the State in which the assignor is located.

"(3) Notwithstanding paragraphs (1) and (2), the application of a provision of the law of the State in which the assignor is located may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.

"(4) If an insolvency proceeding is commenced in a State other than the State in which the assignor is located, 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.

"(5) If an insolvency proceeding is commenced in a State other than the State in which the assignor is located, any [non-consensual] [preferential] right or interest which under the law of the forum State would have priority over the interest of an assignee has such priority notwithstanding paragraph (2). [A State may deposit at any time a declaration identifying those [non-consensual] [preferential] rights or interests which have priority over the interests of an assignee notwithstanding application of the priority rule set out in paragraph (2).]

"(6) An assignee asserting rights under this article has no less rights than an assignee asserting rights under other law."

33. With regard to paragraphs (1) and (2), the Working Group confirmed its understanding that they were intended to apply irrespective of the place in which a proceeding commenced.

34. Recalling its decision to include at the beginning of draft article 24 the words "With the exception of matters which are settled in this Convention" (see para. 21), the Working Group decided that the same wording should be included in draft article 25 to apply to both paragraphs (1) and (2).

35. The Working Group noted that, in paragraph (2), the term "assignor's creditors" had been substituted for the term "insolvency administrator", since: in some legal systems, the insolvency administrator did not become the holder of the rights of the creditors; and, in some reorganization proceedings, there might be no insolvency administrator. However, in view of the fact that, in other legal systems, the insolvency administrator did become the holder of the creditors' rights, the Working Group decided that a reference to the insolvency administrator should be inserted in paragraph (2).

36. As to the policy underlying paragraph (3), it was noted that it was intended to strike a balance between the need to ensure certainty and the need to preserve fundamental policy decisions of the law of the forum State. Accordingly, the right of the forum State to set aside a provision of the law applicable was recognized and, at the same time, limited to cases in which that provision was manifestly contrary to the public policy of the forum State. It was observed that, by definition, paragraph (3) referred to international public policy, the application of which could result in setting aside a priority rule of the law applicable but not in the positive application of a priority rule reflecting the public policy of the forum State. The Working Group noted that the matter was appropriately explained in the commentary (see A/CN.9/WG.II/WP.106, paras. 89-90).

37. As to the scope of paragraph (3), a number of suggestions were made. One suggestion was that paragraph (3) should be revised to be made applicable only in the case of a conflict of priority arising in an insolvency proceeding. In support of that suggestion, it was stated that a broader public policy exception would create uncertainty and thus have a negative impact on the availability and the cost of credit. It was also observed that such an approach would be in line with paragraph (5), which was intended to preserve super-priority rights arising by operation of law only in an insolvency proceeding. That suggestion was objected to on the ground that the right of a court or other authority to apply its own public policy could not be limited. It was stated that such a limitation could reduce the acceptability of the draft Convention. It was also said that, in any case, it would be doubtful whether such a limitation, even if included in paragraph (3), would be implemented by courts. Another suggestion was that paragraph (3) should be revised to be made applicable only to cases in which a proceeding commenced in a State other than the State of the assignor's location. While it was agreed that a conflict between the applicable law and the public policy of the forum State could arise only if two jurisdictions were involved, it was generally felt that no change was necessary. Paragraphs (1) and (2) were generally thought to sufficiently reflect the understanding that, if the law applicable to priority and the law governing any insolvency or other proceeding were laws of a single jurisdiction, the internal rules of that jurisdiction would resolve any conflict. Yet another suggestion was that the words "notwithstanding paragraphs (1) and (2)" were superfluous and should be deleted. On the understanding that even without those words paragraph (3) sufficiently reflected the fact that it applied both within and outside an insolvency proceeding, the Working Group approved that suggestion.

38. With regard to paragraph (4), the Working Group noted that it was intended to preserve rights of the insolvency administrator or the assignor's creditors in a proceeding opened in a State other than the State of the assignor's location ("secondary insolvency proceeding"). Such rights, while falling short of reflecting the public policy of the forum State, were based on rules of mandatory law (e.g. the right to challenge the validity of an assignment on the ground that it was a preferential or fraudulent transfer). It was observed that, in view of the fact that paragraphs (1) and (2) dealt with priority questions without

affecting special rights based on insolvency law, paragraph (4) was superfluous and could be deleted. It was also stated that the words "except as provided in this article" raised doubts as to whether the rights that were intended to be preserved were in fact protected. After discussion, the Working Group decided that paragraph (4) should be deleted.

39. As to paragraph (5), it was noted that it was intended to preserve super-priority rights (e.g. in favour of the State for tax claims or of employees for wages) in the case of an insolvency proceeding commenced in a State other than the State of the assignor's location. A number of suggestions were made as to the appropriate term to reflect those super-priority rights. One suggestion was that those rights should be qualified as non-consensual rights. That suggestion was objected to on the ground that it might not sufficiently cover preferential rights which arose out of consensual relationships. Another suggestion was that the term "preferential" should be used. That suggestion was objected to on the ground that it would inadvertently result in broadening the scope of the exception from the rule of paragraph (2) and in giving priority to creditors of the assignor that had a property right in receivables recognized in a court judgement. Yet another suggestion was that no qualification of the rights arising under the law of the forum State was necessary. That suggestion too was objected on the ground that it would in effect overturn the rule of paragraph (2) and subject priority to the law of the forum State. Yet another suggestion was that the super-priority rights meant in paragraph (5) could be described as preferential rights arising by operation of the law of the forum and having priority status in an insolvency proceeding in the forum State. That suggestion received sufficient support.

40. With regard to paragraph (6), the Working Group noted that it was originally intended to ensure that an assignee asserting priority under the substantive law provisions of the draft Convention would not have less rights than if it asserted priority under substantive law outside the draft Convention (A/CN.9/455, para. 40; and A/CN.9/445, para. 44). It was also noted that, once the Working Group decided to turn the priority rules of the draft Convention into private international law rules (A/CN.9/445, para. 22), paragraph (6) did not appear to be appropriate. It was observed that paragraph (6) appeared suggesting that, although a conflict of priority was covered by the draft Convention, a law other than the law of the assignor's location might be applicable. After discussion, the Working Group decided that paragraph (6) should be deleted.

41. The Working Group adopted draft article 25 as amended and referred it to the drafting group.

Article 26. *Competing rights with respect to payments*

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

"[(1) If payment with respect to the assigned receivable is made to the assignee, the assignee has a property right in whatever is received in respect of the assigned receivable.

"(2) If payment with respect to the assigned receivable is made to the assignor, the assignee has a property right in whatever is received in respect of the assigned receivable if:

(a) what is received is money, cheques, wire transfers, credit balances in deposit accounts or similar assets ("cash receipts");

(b) the assignor has collected the cash receipts under instructions from the assignee to hold the cash receipts for the benefit of the assignee; and

(c) the cash receipts are held by the assignor for the benefit of the assignee separately from assets of the assignor, such as in the case of a separate deposit account containing only cash receipts from receivables assigned to the assignee.

"(3) With respect to the property rights referred to in paragraphs (1) and (2) of this article, the assignee has the same priority as it had in the assigned receivables.

"(4) If payment with respect to the assigned receivable is made to the assignor and the requirements of paragraph (2) are not met, priority with respect to whatever is received is determined as follows:

(a) if what is received is a receivable, priority is governed by the law of the State in which the assignor is located;

(b) if what is received is an asset other than a receivable, priority is governed by the law of the State in which it is located.

"(5) Paragraphs (3) to (5) of article 25 apply to a conflict of priority arising between an assignee and the insolvency administrator or the assignor's creditors with respect to whatever is received.]"

43. The Working Group noted that paragraphs (1) and (2) were intended to give the assignee a right in rem in proceeds, without affecting the order of priority established in paragraphs (3) and (4). It also noted that, in order to better reflect that understanding, the secretariat had separated the issue of priority in proceeds from the issue of the remedies available to an assignee with priority in such proceeds and addressed those issues in two separate provisions that were as follows:

"Article 26. *Priority in proceeds*

"(1) Priority among several assignees of the same receivables from the same assignor and between the assignee and the assignor's creditors or the insolvency administrator with respect to whatever is received in payment [, or other discharge,] of the assigned receivable is determined as follows:

(a) if what is received is a receivable, priority is governed by the law of the State in which the assignor is located;

(b) if what is received is an asset other than a receivable, priority is governed by the law of the State in which it is located.

"(2) Paragraphs (3) to (5) of article 25 apply to a conflict of priority arising between an assignee and the assignor's creditors or the insolvency administrator with respect to whatever is received in payment [, or other discharge,] of the assigned receivable.

"Article 26*bis*. *Rights in rem in proceeds*

"(1) With the exception of the cases foreseen in paragraphs (2) to (4) of this article, whether an assignee [has a right in rem or ad personam in] [is entitled to claim and retain] whatever is received in payment [, or other discharge,] of the assigned receivable is subject to the law governing priority under article 26 of this Convention.

"(2) If payment [, or other discharge,] with respect to the assigned receivable is made to the assignee, the assignee with priority over the assignor's creditors or the insolvency administrator under article 26 of this Convention has [a right in rem in] [the right to retain] whatever is received up to the value of its right in the receivable[, including interest].

"(3) If payment [, or other discharge,] with respect to the assigned receivable is made to the assignor, the assignee with priority over the assignor's creditors or the insolvency administrator under article 26 of this Convention has [a right in rem] [the right to retain] whatever is received up to the value of its right in the receivable [, including interest,] if:

(a) the assignor has received payment [, or other discharge,] under instructions from the assignee to hold whatever it received for the benefit of the assignee; and

(b) whatever the assignor received is held by the assignor for the benefit of the assignee separately and is reasonably identifiable from assets of the assignor, such as in the case of a separate deposit account containing only cash receipts from receivables assigned to the assignee."

44. The Working Group decided to use those draft articles as a basis for the continuation of its deliberations.

Priority in proceeds

45. It was generally agreed that priority in proceeds that were receivables, including receivables in the form of negotiable instruments, as well as balances in deposit and securities accounts, should be governed by the law of the assignor's location.

46. With regard to priority in other types of proceeds, such as goods, a number of suggestions were made. One suggestion was to retain draft article 26 (1) *(b)*, proposed by the secretariat, as it was or with the addition of language aimed at ensuring that the rights of third parties in goods were not affected. That suggestion did not receive sufficient support. Another suggestion was that priority in proceeds in the form of goods should be governed by the law of the assignor's location. In support of that view, it was observed that the application of the law of a single and easily determinable jurisdiction would enhance certainty. It was also stated that such an approach would be in line with the approach taken with regard to priority in receivables, which deviated from the traditional approach of the law of the "location" of a receivable (i.e. of the place in which it was payable). That suggestion was objected to on the ground that such an approach could frustrate the expectations of third parties in the country where the goods were located and reduce the acceptability of the draft Convention. Yet another suggestion was that a distinction should be drawn between goods received in total or partial satisfaction of the receivable and goods returned (e.g. because they were defective and the sale contract had been cancelled or because the sale contract allowed the buyer to return those goods after a trial period). It was stated that the former type of goods were another form of the same receivable and priority with respect to those goods should be subject to the same rule as priority with respect to receivables, while the latter type of goods had no relationship with the receivable and priority with respect to those goods should be subject to the law of their location. That suggestion attracted sufficient support. The Working Group requested that the commentary include an explanation of the notion of "returned goods".

47. In the discussion, the Working Group noted that the issue of proceeds arose also in the context of article 16 with respect to the relationship between the assignor and the assignee. The question was raised as to whether the assignee's right in proceeds as against the assignor should extend to goods given in total or partial satisfaction of the assigned receivable. The Working Group postponed discussion of that question until it had completed its review of draft article 16 (see para. 120).

48. It was agreed that the term "proceeds" should be defined, without prejudice to the question whether "returned goods" would be covered in draft article 16 (see para. 120). Language along the lines of draft article 16 (1) *(a)* was generally considered to be acceptable ("whatever is received with respect of the assigned receivable"), with the addition of the notions of payment and satisfaction of the assigned receivable, whether total or partial. As to the use of the term "discharge", objections were raised on the ground that that term implied payment in full.

49. After discussion, the Working Group adopted draft article 26 as amended and referred its formulation, as well as the formulation of the definition of the term "proceeds", to the drafting group.

Rights in rem in proceeds

50. With regard to draft article 26*bis*, a number of concerns were expressed. One concern was that draft article 26*bis* was complicated and inappropriately dealt with substantive law issues in paragraph (1) and private international law issues in paragraphs (2) and (3). Another concern was that in creating rights in rem in proceeds, draft article 26*bis* was inconsistent with fundamental notions of law in many countries that did not recognize such rights and yet provided sufficient protection for assignees. Yet another concern was that draft article 26*bis* was unnecessary since parties could structure their transactions so as to meet their needs.

51. In response, it was stated that a right in rem in the limited cases described in paragraphs (2) and (3) of draft article 26*bis* could significantly facilitate non-notification factoring transactions, securitization transactions and transactions involving sovereign receivables, in which assignors received payments on behalf of assignees and normally held such payments in separate accounts, since, with such

a right, assignees would be protected in the case of insolvency of assignors. If, in order to be protected, assignees would need to notify debtors and structure their transactions so as to receive payments themselves, non-notification and the other practices mentioned above would be hampered and the costs of those transactions would increase. It was also observed that, the estate of the assignor having been enriched through the credit provided by the assignee to the assignor in return for the receivables, allowing the insolvency administrator or the creditors of the assignor to receive payment of the receivables should be considered as unjust enrichment. Furthermore, it was stated that, while such in rem rights in proceeds of receivables might be foreign to many jurisdictions, fiduciary arrangements, on the basis of which assignors received payments on behalf of assignees and had certain obligations as against such assignees, were not unknown, if not in statutory, at least, in case law of those jurisdictions. It was, therefore, suggested that, if an assignee had priority in the assigned receivable, the assignee or the assignor received payment, payment was received by the assignor on behalf of the assignee and the proceeds of payment were held by the assignor separately, that assignee should be given priority with regard to those proceeds. That suggestion received sufficient support.

52. In the discussion, the suggestion was made that the rules to be prepared should also cover the extent of the assignee's right in the assigned receivable, the existence and the extent of the assignee's right in proceeds, as well as the existence and the extent of the right of a creditor, who had a right in other property of the assignor, which right was, by operation of law, extended to the assigned receivable. That suggestion too received sufficient support.

53. After discussion, the Working Group requested the drafting group to formulate a specific rule with regard to priority in proceeds along the lines mentioned in paragraphs 51 and 52 above, which would not address the question of the legal nature of rights in proceeds. The Working Group left to the drafting group the question of consolidating the priority rules contained in section III of chapter IV of the draft Convention in one or more rules.

Article 4. *Exclusions*

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

"[(1)] This Convention does not apply to assignments:

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

(b) to the extent made by the delivery of a negotiable instrument, with any necessary endorsement;

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

"[(2) This Convention does not apply to assignments listed in a declaration made under draft article 35 by the State in which the assignor is located, or with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, by the State in which the debtor is located.]"

General remarks

55. Some doubt was expressed as to whether draft article 4 was necessary. The Working Group recalled its decision that the scope of application of the draft Convention should not be limited by reference to the commercial or financing purpose of a transaction. The Working Group also recalled its decision that assignments for consumer purposes and certain practices that did not need to be regulated should be excluded. The Working Group, therefore, confirmed its decision that draft article 4 should be retained and decided that the brackets in paragraph (2) should be removed on the understanding that draft article 35 would be reviewed at a later stage (as to the brackets around draft article 4 (2), see paras. 86, 199-201 and 211).

56. The Working Group went on to consider exclusions relating to assignments for consumer purposes, assignments of receivables arising from financial instruments, funds transfer orders, payment and securities settlement systems and from deposit accounts, as well as assignments of receivables arising from the sale and lease of aircraft and other types of mobile equipment.

Assignments for consumer purposes

57. It was noted that subparagraph *(a)* was intended to limit the scope of the draft Convention to commercial transactions, whether they related to trade or to consumer receivables. It was also noted, however, that, in its current formulation, subparagraph *(a)* might result in excluding inappropriately certain commercial transactions, such as: assignments of insurance policies from consumers to financing institutions; and assignments from consumers to financing institutions in return for loans used for consumer purposes. In order to address that problem, a number of suggestions were made. One suggestion was to ensure that only assignments "exclusively" for consumer purposes would be excluded. Another suggestion was to exclude transactions "made from an individual to an individual for personal, family or household purposes". Neither suggestion was found to be sufficient in reflecting the general understanding of the Working Group that only assignments from a consumer to a consumer should be excluded. Another suggestion was to make explicit reference to the term "consumer". That suggestion was objected to on the ground that the term "consumer" was not universally understood in the same way.

58. Yet another suggestion was that subparagraph *(a)* should be replaced by a general provision aimed at ensuring that the rights of consumers were not affected by the draft Convention. It was stated that that provision might be limited to consumer-protection legislation. That suggestion was objected to on the grounds that such a provision would be unnecessary in view of the fact that the draft Convention was not intended to override consumer-protection law; and would inadvertently result in excluding significant practices involving the assignment of consumer receivables. The Working Group confirmed its decision that, unlike the Unidroit Convention on International Factoring (Ottawa, 1988; hereinafter referred to as "the Ottawa Convention"), the application of which was limited to trade receivables, the draft Convention should cover commercial practices involving the assignment of consumer receivables.

59. After discussion, the Working Group decided that only assignments made from a business entity or a consumer to a consumer and only if made for consumer purposes should be excluded, adopted subparagraph *(a)* on that understanding and referred its exact formulation to the drafting group.

Assignments of receivables arising from financial instruments, funds transfer orders, payment and securities settlement systems, and deposit accounts

60. It was stated that financial instruments, such as money-market and stock-exchange instruments, swaps and derivatives, were traditionally governed by international standard agreements, such as the International Swaps and Derivatives Association (ISDA) Master Agreement and the International Securities Market Association (ISMA) Master Agreement, or other national standard agreements. It was also observed that those standard agreements usually included a clause under which a party could not assign its claim against the other party without that party's consent. In the case of a breach of such a clause, it was said, a party had the right to terminate not only the transaction in question but all the transactions governed by a master agreement. It was added that many master agreements contained a cross-default clause, under which, in the case of any such breach, all the transactions governed by all those master agreements could be terminated. In addition, it was observed that, under standardized arrangements existing with regard to the execution of funds transfer orders and payment of securities among participants of payments and securities settlement systems, the assignment of receivables from transfer orders was normally prohibited. Moreover, it was said that it was normal practice for financing institutions to preclude in their general terms and conditions their clients from assigning receivables arising from deposit accounts. It was explained that such receivables were regularly used as collateral for credit facilities offered by financing institutions to their clients.

61. It was observed that, contrary to such practices, draft article 10 (1) validated assignments made in violation of an anti-assignment clause, without, however, precluding the debtor from terminating the transactions in question or all transactions governed by a master agreement or more than one master agreement with a cross-default clause. It was also stated that such a result could undermine international financial markets. In addition, it was observed that validating the assignment of receivables arising from deposit accounts in violation of anti-assignment clauses could impair the relationship between financing institutions and their clients, pose problems in the use of those deposit accounts as collateral for credit facilities offered by such institutions and increase the risk of money laundering. Moreover, draft article 20 (3), under which the debtor could not raise against the assignee any claim that the debtor might have against the assignor for breach of an anti-assignment clause, was said to create serious problems for swaps and derivatives markets. It was explained that such a provision would render useless netting arrangements that formed a key component of such financial transactions. It was also stated that such a provision would run counter to normal practices existing under master repurchase and master netting agreements.

62. There was general agreement in the Working Group that the above-mentioned concerns should be addressed. Differing views were expressed, however, as to the most appropriate way to address them. One view was that, in order to avoid undermining well-functioning practices, transactions involving money market or stock exchange instruments, swaps and derivatives, and receivables arising from transfer orders or settlements through payment or securities settlement systems should be excluded from the scope of the draft Convention by way of a blanket exclusion in draft article 4. In support of that view, it was observed that an exclusion in draft article 4 was preferable for reasons of simplicity and predictability. Alternatively, if consensus could not be reached by the Working Group on such a blanket exclusion, such transactions could be covered by the draft Convention on the condition that an assignment made without the consent of the debtor would be treated as null and void. The suggestion was also made that the latter approach could be followed in any case with regard to receivables from deposit accounts.

63. In order to implement the first suggestion mentioned above, it was stated that a new paragraph should be added to the preamble in order to express the specificity of receivables arising from deposit accounts as well as receivables arising from transactions involving such financial instruments.

64. Concerning receivables arising from deposit accounts, language along the following lines was proposed:

"Article 1. *Scope of application*

"(1) This Convention applies to:

...

(d) receivables arising from deposit accounts subject to the conditions of article 8 (3)".

"Chapter III. *Validity and effects of assignment*

"Article 8. *Validity and effectiveness of bulk assignments, assignments of future receivables, partial assignments and assignments of receivables arising from deposit accounts*

...

"(3) An assignment of receivable(s) arising from deposit accounts is valid and effective subject to the prior explicit consent of the debtor. Any assignment made in breach of this provision shall be deemed null and void under the present Convention."

65. Concerning receivables arising from transactions involving financial instruments, language along the following lines was proposed:

"Article 4. *Exclusions*

"[(3)] This Convention does not apply to receivables arising from:

(a) transactions involving financial instruments such as money-market or stock exchange instruments, swaps and other derivatives,

(b) transactions involving the temporary assignment of securities for cash,

(c) transfer orders or settlements through a payment or securities settlement system."

66. Alternatively, in the event that consensus could not be reached on the amendments mentioned in paragraph 65 above, language along the following lines was proposed:

"Article 1. *Scope of application*

"(1) This Convention applies to:

...

(e) receivables arising from transactions:

(i) involving financial instruments such as money-market and stock exchange instruments, swaps and other derivatives, receivables arising from transactions involving the temporary assignment of securities for cash and, in both cases, any collateral related to, under the express reservation of article 10 (2) (i),

(ii) transfer orders or settlements through a payment or securities settlement system under the express reservation of article 10 (2) (ii)."

"Article 10. *Contractual limitations on assignment*

"(2) Paragraph (1) shall not apply to receivables arising from:

(i) transactions involving financial instruments such as money-market and stock exchange instruments, swaps and other derivatives, receivables arising from transactions involving the temporary assignment of securities for cash, unless the debtor has explicitly consented to the assignment**,** whether or not there is a contractual clause limiting in any way the assignor's right to assign its receivables,

(ii) transfer orders or settlements through payment or securities settlement systems, unless the rules of such systems explicitly authorize such assignment."

67. Whether the Working Group preferred the wording mentioned above in paragraph 65 or in paragraph 66 above, the following definitions were proposed for addition to draft article 5:

"(...) 'Derivatives' means forward transactions related to stock exchange or market prices of [...] securities, money-market instruments, currencies, units of account, commodities, precious metals or interest rates or other income or to the creditworthiness of debtors, including spot and forward foreign exchange transactions and options on the above defined transactions or any combination thereof, or similar transactions.

"(...) 'Payment or securities settlement systems' means contractual arrangements between three or more participants with common rules for the settlement of payment or security transfer orders and any collateral related to between the participants, supported by a central counterparty, settlement agent or clearing house.

"(...) 'Temporary assignment of securities for cash' means repurchase and reverse repurchase transactions, as well as borrowing and lending transactions on financial instruments, such as securities or money-market instruments and similar transactions."

68. While the proposals mentioned above were met with great interest, the view was expressed that an outright exclusion or an invalidation of assignments not only as against the debtor but as against all parties would go far beyond what was needed to address the above-mentioned debtor-related concerns. It was stated that such an approach would unnecessarily deprive assignees of even a right in the proceeds after payment by the debtor of a financial receivable. In addition, it was observed that a blanket exclusion could result in excluding composite transactions involving the assignment of both trade and financial receivables. The suggestion was, therefore, made that it would be preferable to include those transactions in the scope of the draft Convention, while making the necessary adjustments so as to address the debtor-related concerns.

69. As to the types of adjustments that would need to be made, it was stated that rules dealing with payment to a new creditor (draft articles 17-19), rights of set-off of the debtor (draft article 20 (2) and (3)) and the right of the debtor to modify the original contract (draft article 22) should apply only to trade receivables (i.e. receivables arising from the sale of goods or the provision of services) and to transactions in which there was no restriction on assignment in the original contract. As a result, it was said, if there was a contractual restriction on the assignment of a receivable other than a trade receivable, the assignment would have no effect on the debtor's rights and obligations (i.e. the debtor would not need to pay the assignee and would not lose its rights of set-off or its right to modify the original contract), unless the debtor consented to the assignment. In view of that additional protection and in order to avoid the problems described above with regard to default and cross-default rules in master agreements (see paras. 60 and 61), the debtor of a receivable other than a trade receivable would not have the right to claim breach of, or terminate, the original contract on account of the assignment.

70. Such an approach was said to have several advantages, including the following: that it would address the special interests of debtors of financial receivables; that it would preserve an acceptable debtor-protection regime for debtors of trade and consumer receivables; that, in the case of an assignment of a financial receivable, it would allow the application of the draft Convention as between the assignor and the assignee and as against competing assignees, creditors of the assignor and the administrator in the insolvency of the assignor; and that it would avoid the difficulty in defining financial receivables, which would be difficult to define as indicated in the above-mentioned proposal (see para. 67).

71. Language along the following lines was proposed:

"Article 5. *Definitions and rules of interpretation*

"(...)"trade receivable" means a receivable arising under an original contract for the sale or lease of goods or the provision of services.

"Article ... *Special Provisions Relating to Debtors on Receivables that are not Trade Receivables*

"(1) This article applies only to a receivable that is not a trade receivable and only to the extent of a restriction on assignment provided in an agreement described in articles 10 (1) and 11 (2).

"(2) Notwithstanding articles 17, 18 and 19, an assignment of the receivable, and receipt by the debtor of a notification of the assignment or payment instruction, shall have no effect under this Convention on the debtor's rights or obligations except to the extent that the debtor consents.

"(3) Notwithstanding article 20 (2), nothing in this Convention limits any right of the debtor to raise against the assignee any defence or set-off available to the debtor, even if the defence or set-off became available to the debtor after the time notification of the assignment was received.

"(4) Notwithstanding article 22, nothing in this Convention limits the effectiveness against the assignee of an agreement concluded at any time between the assignor and the debtor to modify the original contract.

"(5) Notwithstanding articles 10 (2) and 11 (3), an assignor who assigns a receivable is not liable to the debtor for breach of the restriction on assignment and the breach shall have no effect."

72. It was also proposed that language along the following lines could be added at the end of articles 10, 11, 17, 18, 19, 20 and 22:

"(...) In the case of a receivable that is not a trade receivable, this article is subject to article ...."

It was stated that, if needed, a provision might also be added to article 4 directing attention to the special provisions mentioned above.

73. The proposal set forth in paragraphs 71 and 72 above was met with interest. As a matter of policy, it was widely felt that the Working Group should try to retain as broad a scope of application as possible, while ensuring that the concerns of the industry were addressed. If, after consultation with the industry, that approach were proven to be unworkable, a blanket exclusion could be considered. In response to a question as to the impact of the proposal on the legislative treatment of the assignment of financial receivables, it was stated that certain provisions of the draft Convention would not apply to debtor-related issues (e.g. discharge of the debtor or rights of set-off of the debtor), which would be left, as a result, to law applicable outside the draft Convention. However, it was said, the rest of the provisions of the draft Convention would apply (e.g. draft article 10 (1), and, as a result, the assignment would be effective as between the assignor or the assignor's creditors and the assignee). In addition, it was pointed out that paragraph (5) was based on the assumption that, once the debtor's rights were not affected by the assignment, the debtor did not need to terminate any agreement. It was explained that paragraph (5) was intended to address the problem raised with regard to systemic risks arising in the case of a breach of an anti-assignment clause in the case of master agreements with cross-default clauses.

74. As to the merits of an approach based on a definition of trade receivables, it was stated that, in defining the well-known notion of trade receivables, the proposed text avoided the need for a list of financial receivables, which could be neither homogeneous nor exhaustive. However, a number of concerns were expressed. One concern was that the reference to services in the definition of trade receivables could inadvertently result in financial receivables being treated as trade receivables. In order to address that concern, it was suggested that reference should be made to "services other than financial services". That suggestion received broad support. Another concern was that, in defining financial receivables in a negative way, the proposal might inadvertently result in subjecting inappropriately the assignment of certain types of trade receivables to a special regime (e.g. trade receivables held by a financing institution and assigned to another financing institution). In order to address that concern, it was suggested that the proposed text would need to be examined carefully in consultation with the relevant industry so as to ensure that all different practices were treated appropriately. That suggestion too received sufficient support. Yet another concern was that it might not be appropriate to define in essence the scope of the draft Convention in a negative way. In response, it was observed that such an approach was often followed in legislative texts and, in the present case, presented the obvious advantage of being based on the well-known notion of trade receivables.

75. As to the special regime for the assignment of financial receivables in the proposal, it was stated that it was in line with the policy of the Working Group to cover a range of transactions that would be as broad as possible, while addressing the concerns of the relevant industry. However, the concern was expressed that the proposed text did not make it sufficiently clear whether the special regime applying to the assignment of financial receivables was covered in the draft Convention or was left to law applicable outside the draft Convention. The concern was also expressed that paragraphs (1) to (4) of the proposed text might appear as conferring positive rights rather than creating a special regime under the draft Convention for debtors of financial receivables.

76. For those reasons, the proposal was made that draft articles 10, 11, 17, 18, 19, 20 and 22 should not apply to the assignment of receivables other than trade receivables and that, with respect to such assignments, the matters addressed in those provisions should be left to law outside the draft Convention. There was support for that proposal. It was stated that it might better address the concerns of the industry. It was also observed that that proposal was in line with the policy underlying the proposal mentioned above in paragraphs 64 to 67. The concern was expressed, however, that that proposal went beyond its intended purpose of protecting debtors of financial receivables to the extent that it would unnecessarily result in an anti-assignment clause invalidating an assignment even as between the assignor or the assignor's creditors and the assignee.

77. After discussion, the Working Group was unable to reach a conclusion on the matter and decided that a new article 4*bis* with two alternatives along the lines of the proposals mentioned in paragraphs 71, 72 and 76 above

should be included in the text of the draft Convention for the continuation of the discussion after consultation with the relevant industry. The formulation of new draft article 4*bis* was referred to the drafting group.

Assignments of receivables arising from the sale or lease of aircraft and other types of mobile equipment

78. It was noted that the International Institute for the Unification of Private International Law (Unidroit) was currently preparing, in cooperation with the International Civil Aviation Organization (ICAO), a draft convention on security and other interests in mobile equipment and an aircraft protocol, while further equipment-specific protocols were being prepared in cooperation with other organizations. It was also noted that those texts were aimed at reducing the cost of financing of mobile equipment, the application to which of the lex situs created uncertainty as to the effectiveness of security and similar interests in view of the movement of such equipment across borders and of certain mandatory aspects of national secured transactions law. Furthermore, it was noted that the draft convention and protocols addressed the assignment of receivables arising from the sale and lease of mobile equipment, as well as of insurance proceeds in the case of damage to or loss of such equipment. As to the main differences between the draft Convention and those texts, it was noted that, unlike the draft Convention, those texts: provided a system of self-help, which included the right of the financier to repossess the mobile equipment, even after the commencement of an insolvency proceeding; based priority in the equipment and the receivables arising from the sale and lease of equipment on the time of registration in an equipment-specific registry; and, in view of the high value of the equipment involved, provided that the secured obligation (the receivable for the price of the receivable) followed the legal regime of the accessory security or other similar right in the mobile equipment.

79. The Working Group considered ways to avoid conflicts between the draft Convention and those texts. It was noted that, in order to determine whether assignments of receivables arising from the sale and lease of mobile equipment could be excluded from the draft Convention or from the draft convention and protocols, the Working Group needed to either know the status of current law and practice or to be prepared to draw conclusions as to any generally acceptable new practices that, although they were not sufficiently accommodated under current law, could be accommodated by a new uniform law.

80. The view was expressed, however, that, at least, receivables arising from the sale and lease of aircraft and spacecraft should be excluded from the scope of the draft Convention. In support of that view, it was observed that the assignment of such receivables was an integral part of aircraft and spacecraft financing and should be left to aircraft and spacecraft financing law. Potential financiers of such receivables, it was said, would tend to look to the aircraft registry in order to determine their priority status and to decide whether to provide credit and at what cost. On the other hand, it was stated, receivables arising from ticket sales were normally part of securitization schemes and should not be excluded from the scope of the draft Convention. It was also observed that attempting to address the assignment of such receivables in the draft Convention might reduce the acceptability of the draft Convention to the aircraft industry. In that connection, it was suggested that the commercial financing industry, which included also aircraft financiers and was supporting a scope of the draft Convention that would be as broad as possible, could address that matter in consultation with the aircraft industry, with a view to achieving a more coordinated treatment of aircraft and receivables financing matters in the draft Convention.

81. After discussion, the Working Group generally felt that it did not have the specific information necessary to make a decision for a blanket exclusion of aircraft and spacecraft receivables from the scope of the draft Convention.

82. The Working Group next turned to the question whether any conflict between the draft Convention and those other texts could be left to treaty law. Differing views were expressed. One view was that draft article 33 (2), allowing a State to declare, in the case of a conflict, to which text it wished to give precedence and draft article 35, allowing States to exclude further practices, were sufficient. It was stated, however, that such an approach would result in disparity of legal treatment of the relevant matters and in uncertainty to the extent that States would take differing approaches. Another view was that the matter could be left to general principles of treaty law, under which the more specific or more recent text would prevail. It was stated, however, that that approach should be only the last resort if agreement could not be reached on another approach, since commercial transactions required a higher degree of certainty than could be achieved under such a treaty-law approach.

83. Yet another view was that the draft Convention should give, in a uniform way for all States, precedence to other texts dealing with secured transactions with respect, at least, to aircraft receivables secured by or associated with aircraft and registered in an aircraft registry. Language along the following lines was proposed:

> "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 security interests, conditional sales under reservations of title and leasing agreements with respect to aircraft and receivables arising from the sale or lease secured by or associated with such equipment."

84. The view was expressed that the same approach might need to be followed with respect to the assignment of receivables arising from the sale or lease of spacecraft, as well as with regard to the assignment of any insurance proceeds arising in the case of damage to or loss of spacecraft.

85. Yet another view was that the determination of whether a protocol would supersede the draft Convention could be made in each protocol on the basis of a decision as to whether receivables should be part of specific equipment rather than receivables financing. It was observed, however, that for the draft Convention to refer that matter to each protocol, those texts should be final and the Working Group would need to have sufficient knowledge of their contents. It was stated, that, in particular, the scope of those texts

should be sufficiently clear. In that connection, it was observed that the absence of a definite list of equipment to be covered created the concern that the creation of security and similar rights in "any uniquely identifiable object" might be covered. On the other hand, that concern was said to be unjustified, since it was generally understood among the members of the group preparing the draft convention and protocols that work would be limited to high-value mobile equipment only. It was stated, however, that the concern was legitimate, since the terms "high-value mobile equipment" were not sufficiently clear, or were, at least, not universally understood in the same way. In view of the above, it was suggested that the Working Group should not feel pressured to make a decision. It was pointed out that more information and consultation with the relevant sectors of the industry was necessary and that the matter was of a political nature and might need to be left to the Commission.

86. After discussion, the Working Group agreed that the text of draft article 4 (2) should remain unchanged and without square brackets (see, however, para. 211). It was also agreed that, for the continuation of the discussion, draft article 33 should include a third paragraph within square brackets along the lines mentioned in paragraph 83 above. That matter was referred to the drafting group. It was generally understood that, in any case, draft article 33 would need to be revisited with a view to ensuring that it addressed appropriately conflicts with other international texts (see paras. 192-195).

Article 2. *Assignment of receivables*

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

"For the purposes of this Convention:

(a) 'Assignment' means the transfer by agreement from one person ('assignor') to another person ('assignee') of the assignor's contractual right to payment of a monetary sum ('receivable') from a third person ('the debtor'). The creation of rights in receivables as security for indebtedness or other obligation is deemed to be a transfer;

(b) In the case of an assignment by the initial or any other assignee ('subsequent assignment'), the person who makes that assignment is the assignor and the person to whom that assignment is made is the assignee."

88. It was noted that, under subparagraph *(a)*, what constituted a "contractual" right was left to law applicable outside the draft Convention. In order to avoid the uncertainty that could result in view of the divergences existing between legal systems, it was noted that the term "contractual" right could be defined in the draft Convention in a negative way (e.g. "a right to payment of a monetary sum other than one arising by operation of law or determined in a court judgement"). It was also noted that the Working Group might wish to clarify whether the term "receivable" included: damages for breach of contract (liquidated or not); interest for late payment (contractual interest, statutory interest or interest liquidated in a court judgement); sums payable as dividends (present or future) arising from shares; and receivables based on arbitral awards.

89. In respect of damages for breach of contract, differing views were expressed. One view was that damages should not be treated as receivables. It was stated that the claim of the seller for the purchase price of goods sold under a contract of sale was a right to payment flowing directly from the contract. To the contrary, the claim for damages of the buyer, e.g. for delivery of non-conforming goods by the seller was the result of a contract violation and as such should not be considered as a "contractual right", unless it was liquidated in a settlement agreement. The prevailing view, however, was that damages for breach of contract should be treated in the same way as contractual receivables. In support of that view, it was said that the assignee should be entitled to all payment rights the assignor had been entitled to under the original contract. If damages were to be excluded, it was explained, in some cases the assignee's rights in the assigned receivables would be frustrated. In that connection, regret was expressed that the scope of the draft Convention was limited to contractual rights to payment, excluding contractual rights other than rights to payment and non-contractual receivables.

90. With regard to interest for late payment, it was widely felt that it was included in the term "receivable" if interest was owed under the original contract. In respect of dividends, it was agreed that they should be treated as contractual receivables, whether they were declared or were future, since they arose under a contractual relationship reflected in the share. As to receivables based on arbitral awards, it was generally thought that they should not be covered by the draft Convention.

91. After discussion, the Working Group adopted draft article 2 unchanged. It was agreed that all the matters mentioned above could usefully be explained in the commentary.

Article 3. *Internationality*

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

"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 of the conclusion of the contract of assignment, the assignor and the assignee are located in different States."

93. As a matter of drafting, it was noted that, in order to align the first with the second sentence of draft article 3 and to limit the references in the text to the time when a receivable arose, the words "at the time of the conclusion of the original contract" might be substituted for the words "at the time it arises". Subject to that change, the Working Group adopted draft article 3 and referred it to the drafting group.

Article 5. *Definitions and rules of interpretation*

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

"For the purposes of this Convention:

(a) 'original contract' means the contract between the assignor and the debtor from which the assigned receivable arises;

(b) a receivable is deemed to arise at the time when the original contract is concluded;

(c) 'existing receivable' means a receivable that arises upon or before the conclusion of the contract of assignment; '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 information that is accessible so as to be usable for subsequent reference. Where this Convention requires a writing to be signed, that requirement is met if, by generally accepted means or a procedure agreed to by the person whose signature is required, the writing identifies that person and indicates that person's approval of the information contained in the writing;

(f) 'notification of the assignment' means a communication in writing which reasonably identifies the assigned receivables and the assignee;

(g) 'insolvency administrator' means a person or body, including one appointed on an interim basis, authorized in an insolvency proceeding to administer the reorganization or liquidation of the assignor's assets or affairs;

(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 or other competent authority for the purpose of reorganization or liquidation;

(i) 'priority' means the right of a party in preference to another party;

[*(j)* [For the purposes of articles 24 and 25,] an individual is located in the State in which it has its habitual residence; a corporation is located in the State in which it is incorporated; a legal person other than a corporation is located in the State in which its constitutive document is filed and, in the absence of a filed document, in the State in which it has its chief executive office.]

[*(k)* [For the purposes of articles 1 and 3:]

(i) the assignor is located in the State in which it has that place of business which has the closest relationship to the assignment;

(ii) the assignee is located in the State in which it has that place of business which has the closest relationship to the assignment;

(iii) the debtor is located in the State in which it has that place of business which has the closest relationship to the original contract;

(iv) in the absence of proof to the contrary, the place of central administration of a party is presumed to be the place of business which has the closest relationship to the relevant contract. If a party does not have a place of business, reference is to be made to its habitual residence[;

(v) several assignors or assignees are located at the place in which their authorized agent or trustee is located]]."

95. On the understanding that direct reference would be made in draft articles 3 and 8 (2) to the time of the conclusion of the original contract, the Working Group decided to delete subparagraph *(b)*. With regard to subparagraph *(d)*, the Working Group decided to postpone discussion until it had completed its review of the title and the preamble of the draft Convention. As to subparagraphs *(j)* and *(k)*, the Working Group recalled its decision to replace them with a new provision (see paras. 25-30).

"Location" of the parties (continued)

96. Recalling its earlier discussion of the issue of location, addressed in subparagraphs *(j)* and *(k)* (see paras. 25-30), the Working Group reopened discussion on the basis of a text that was as follows:

"For the purposes of this Convention:

...

"*(j)* (i) a person is located in the State in which it has its place of business;

(ii) *Variant A*

if the assignor or the assignee has more than one place of business, the place of business is that which has the closest relationship to the contract of assignment. For the purposes of articles 24 to [...], the place of business with the closest relationship to the contract of assignment is deemed to be the place where the central administration of the assignor is exercised;

Variant B

if the assignor or the assignee has more than one place of business, the place of business is that place where its central administration is exercised [.A branch [of a person engaged in the business of accepting deposits or providing other banking services] is deemed to be a separate person];

(iii) if the debtor has more than one place of business, the place of business is that which has the closest relationship to the original contract;

(iv) if a person does not have a place of business, reference is to be made to the habitual residence of that person;"

97. On the grounds that a single location rule would be preferable, the Working Group decided to delete variant A of subparagraph *(j)* (ii). Discussion focused on the bracketed language contained in variant B. A number of concerns were expressed. One concern was that, in the case of an assignment of the same receivables by the head office and by a branch in another country, application of the bracketed language would result in priority between competing assignments of the same receivables from the same assignor being governed by the laws of two States. Another concern was that the bracketed language appeared to distin-

guish between place of business and place of a branch. Yet another concern was that use of the term "branch" appeared to be problematic in view of the fact that increasingly transactions were closed through regional offices, departments or units in different countries. Yet another concern was that relating each assignment to the branch from which it was made might create uncertainty, since third parties could not be aware of the internal structure of the assignor and determine the place in which decisions were made. Yet another concern was that, in view of the fact that no distinction was made between branches in the same country and branches in different countries, one legal entity risked to be treated as a group of separate legal entities.

98. In order to address those concerns, a number of suggestions were made. One suggestion was that the bracketed language in variant B should be replaced by wording along the following lines: "or, in the case of branches, where the branch with which the assignment has the closest relationship is located". A related suggestion was to have a location rule along the lines of variant B with the exception just mentioned as to branch offices of banks only. While some support was expressed in favour of those suggestions, they were objected to on the grounds that, in the case of assignments made from branches in different countries, they would result in priority between competing assignments being governed by different laws. Another suggestion was that, in order to avoid that problem, reference should be made to the place with which the original contract had the closest relationship. While that suggestion was met with some interest, it was also objected to on the grounds that, in the case of bulk assignments involving multiple original contracts, priority issues would be referred to a multiplicity of laws. Yet another suggestion was that reference should be made to the branch in whose books the assigned receivables were carried. Language along the following lines was proposed to replace the bracketed wording in subparagraph *(j)* (ii):

> "Notwithstanding the foregoing sentence, if, immediately prior to the assignment, the receivable is carried on the books of a branch of a financial services provider, the assignor is located in the State in which that branch is located. If, immediately after the assignment, the receivable is carried on the books of a branch of financial services provider, the assignee is located in the State in which that branch is located.

99. In addition, definitions along the following lines were proposed for inclusion in draft article 5:

> "(...) A 'financial service provider' is a bank or other financial institution that, in the ordinary course of its business, accepts deposits, makes loans or [provides other financial services'].
>
> "(...) A 'branch' of a financial service provider is a place of business of the financial service provider that is located in a different State than the financial service provider's place of central administration and that is separately regulated by the State in which the branch is located under the laws applicable to financial service providers in that State.
>
> "(...) A receivable 'is carried on the books' of a branch of a financial service provider if either:
>
> (i) under [accounting] [regulatory] standards applicable to the branch, the receivable is an asset of that branch; or
>
> (ii) in cases in which, because the financial service provider's interest in the receivable is only as security, the receivable is not [considered] an asset of the financial service provider, the rights for which the receivable is security are an asset of that branch."

100. Due to the lack of time, the Working Group was not able to discuss the proposed text. It was understood that the inclusion of the proposed text in the report would allow States to consider its merits in their preparations for the Commission session.

Form of assignment

101. It was noted that, after the deletion of the provision that dealt with form of an assignment, formal validity was left to the law applicable outside the draft Convention. In view of the fact that priority presupposed both substantive and formal validity, it was noted that an assignee would have to ensure that it had a valid assignment under the provisions of the draft Convention and under the law governing formal validity, as well as priority under the law of the assignor's location. In order to avoid such complications, it was suggested that the formal validity of the assignment as a transfer of property should be explicitly addressed in the draft Convention, perhaps by reference to the law of the assignor's location.

102. Differing views were expressed, however, as to the law that was most appropriate to govern formal validity. One view was that subjecting formal validity to the law of the assignor's location would enhance certainty and would simplify compliance on the part of the assignee, which might have an impact on whether priority would be vested in the assignee. Another view was that it would be more consistent with current trends in private international law to provide in the alternative that the assignment would be valid if it met the requirements of the law of the assignor's location or the law of the State in which the assignment was made. Yet another view was that a reference to the law of the assignor's location might run counter to private international law practice. It was also pointed out that such an approach might have a negative impact on international trade practices, since the law of the assignor's location might be irrelevant to the transaction in question.

103. After discussion, it was agreed that the draft Convention should not contain any provision in respect of formal validity and that that matter should be left to the law outside the draft Convention.

Article 10. *Contractual limitations on assignments*

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

> "(1) An assignment of a receivable is effective notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent

assignee, 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 for breach of such an agreement. A person who is not party to such an agreement is not liable under that agreement for its breach."

105. It was noted that the second sentence of paragraph (2) appeared to be stating the obvious (i.e. that the assignee could not have contractual liability for breach of a contract to which the assignee was not a party). In order to reflect the meaning intended by the Working Group (A/CN.9/455, paras. 50 and 51), it was suggested that the words "under that agreement for its breach" could be replaced by language along the following lines: "even if it had knowledge of such an agreement" or "on the sole ground that it had knowledge of such an agreement" or "unless that person acts with the specific intent to cause loss or recklessly and with actual knowledge that the loss would be likely to result".

106. It was agreed that the third alternative introduced an inappropriate limitation on any liability that the assignee might have under law applicable outside the draft Convention. After discussion, the second alternative was found to be preferable on the ground that it reflected in a clearer way that it was not intended to establish liability of the assignee if something more than knowledge was involved. Subject to that change and to any other changes the Working Group agreed upon so as to address issues of financial receivables (see para. 86), the Working Group adopted draft article 10 and referred it to the drafting group.

Article 12. *Limitations relating to Governments and other public entities*

107. The text of draft article 12 as considered by the Working Group was as follows:

"Articles 10 and 11 do not affect the rights and obligations of a debtor, or of any person granting a personal or property right securing payment of the assigned receivable, if that debtor or person is a governmental department[, agency, organ, or other unit, or any subdivision thereof, unless:

(a) the debtor or person is a commercial entity; or

(b) the receivable or the granting of the right arises from commercial activities of that debtor or person.]"

108. It was recalled that draft article 12 was the result of a decision made at the previous session of the Working Group to ensure that sovereign debtors were not affected by assignments made in violation of anti-assignment clauses included in public procurement and other similar contracts. The Working Group thought that any interference with the legal regime of such contracts should be avoided, since it could seriously affect the acceptability of the draft Convention (A/CN.9/456, para. 115).

109. The concern was expressed that the reference to "commercial entity" and "commercial activities" in subparagraphs *(a)* and *(b)* would result in draft article 12 failing to protect sovereign debtors in those countries where government entities and their activities did not normally operate under a specific body of public law but were governed by the same rules as "commercial" entities and activities. With a view to alleviating that concern, while reflecting even more strongly the above-mentioned policy decision, the following text was proposed as a substitute for draft article 12:

"(1) Articles 10 and 11 do not apply to the assignment of a receivable arising from a contract where the debtor is a public entity.

"(2) A 'public entity' includes a government department, a federal, regional or local authority or a body controlled by a public entity.

"(3) A 'body controlled by public entity' is any body

(a) established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character;

(b) having a legal personality; and

(c) financed for the most part or subject to management supervision by a public entity or having an administrative managerial or supervisory body more than half of whose members are appointed by a public entity."

110. Some support was expressed in favour of the proposal. The concern was expressed, however, that the proposed exception was excessively broad in that it would result in protecting inappropriately sovereign debtors who acted as commercial parties or in the context of commercial transactions. In order to address that concern, it was suggested that the exception should be limited to public entities acting in the exercise of their public functions. That suggestion was objected to on the ground that it was the prerogative of each State to determine which types of public entities it wished to protect.

111. It was widely felt, however, that both the proposed text and draft article 12, in establishing a rule that would be applicable to all sovereign debtors, might go beyond their intended purpose. It was observed that such a rule would result in protecting sovereign debtors who might not need such protection or who could be protected by other means (e.g. by a statutory anti-assignment limitation to the extent it was not affected by the draft Convention). It was stated that, while such sovereign debtors could decide whether to make use of the protection they were afforded by virtue of draft article 12 by determining whether to include an anti-assignment clause in their contracts, draft article 12 would still be seen as codifying generally acceptable good practice, a conclusion that the Working Group had never reached.

112. In addition, it was stated that the possibility of a contractual limitation to assignment invalidating the assignment as against a sovereign debtor might inadvertently raise the risk of non-collection from a sovereign debtor and thus raise the cost of credit to all sovereign debtors, irrespective of whether they needed the protection provided under draft article 12. Moreover, it was pointed out that allowing anti-assignment clauses in public procurement contracts to invalidate assignments as against a sovereign debtor could inadvertently raise the cost of credit to small-

and medium-size suppliers of goods and services, which would make it even harder for them to compete for public procurement contracts with large suppliers who normally had alternative sources of credit.

113. As a compromise, it was suggested that draft article 12 should be revised so as to allow States to freely determine which entities they wished to protect, but only by way of a reservation in respect of the application of draft articles 10 and 11 to sovereign debtors. It was widely felt that a new provision should be added to that effect to the final clauses of the draft Convention along the following lines: "A State may declare at any time that it will not be bound by draft articles 10 and 11 if the debtor or any person granting a personal or property right securing payment of the assigned receivable is located in that State at the time of the conclusion of the original contract and is a Government, central or local, any subdivision thereof, or any public entity. If a State has made such a declaration, articles 10 and 11 do not affect the rights and obligations of that debtor or person". The suggestion was also made that the declaration should specify the types of entities to be protected. That suggestion was objected to on the ground that it would inappropriately limit the ability of States in effectively making use of their right to make such a declaration.

114. In the discussion, some doubt was expressed as to whether powerful debtors, such as sovereign debtors deserved any special protection. The view was also expressed that sovereign debtors could be protected in the same way as debtors of financial receivables. In response, it was stated that issues concerning sovereign debtors were different from those arising with regard to debtors of financial receivables and included the need for special protection for public funds as well as the need of sovereign debtors to be able to determine that they were dealing with reliable institutions.

115. After discussion, the Working Group decided that draft article 12 should be deleted, adopted the new provision mentioned in paragraph 113 above and referred its specific formulation and exact placement in chapter VI (final provisions) to the drafting group.

Article 15. *Right to notify the debtor*

116. 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 or the assignee or both may send the debtor a notification of the assignment and a payment instruction, but after notification is sent only the assignee may send a payment instruction.

"(2) A notification of the assignment or payment instruction sent in breach of any agreement referred to in paragraph (1) of this article is not ineffective for the purposes of article 19 by reason of such breach. 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."

117. It was noted that the first sentence of draft article 15 (2) appeared to deal with debtor-related issues and might be moved to draft article 18 or 19. The Working Group adopted draft article 15 and referred the matter to the drafting group.

Article 16. *Right to payment*

118. 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 and whether or not a notification of the assignment has been sent:

(a) if payment with respect to the assigned receivable is made to the assignee, the assignee is entitled to retain whatever is received in respect of the assigned receivables;

(b) if payment with respect to the assigned receivable is made to the assignor, the assignee is entitled to payment of whatever has been received by the assignor.

"(2) If payment with respect to the assigned receivable is made to another person over whom the assignee has priority, the assignee is entitled to payment of whatever has been received by such person.

"(3) The assignee may not retain more than the value of its right in the receivable."

119. The concern was expressed that draft article 16 might appear as dealing with rights of third parties in proceeds. In order to alleviate that concern, it was suggested that: the chapeau of paragraph (1) should be reformulated along the following lines: "As between the assignor and the assignee, unless otherwise agreed, and whether or not ..."; and that paragraph (2) should be moved to the end of paragraph (1) as subparagraph *(c)*. Those suggestions received broad support.

120. Recalling its decision that "proceeds" in the case of competing third-party rights should not include returned goods (see paras. 46-48), the Working Group decided that, as between the assignor and the assignee, the assignee had the right to claim payment in cash or in kind, as well as any proceeds in the form of returned goods. It was stated that there was no reason to limit the ability of the assignor and the assignee to agree that the assignee could claim any returned goods. It was also observed that, even in the absence of an agreement, a default rule allowing the assignee to claim any returned goods could reduce the risks of non-collection from the debtor and thus have a positive impact on the cost of credit.

121. In response to questions raised, it was observed that paragraph (3) applied to both paragraphs (1) and (2) in that it was intended to reflect current practice in assignments by way of security. In line with such practice, paragraphs (1) and (2) allowed the assignee to claim full payment from the debtor, the assignor or a third party, while paragraph (3) provided that it could retain only an amount up to the value of its right in the assigned receivable, including any interest if interest was owed on the ground of contract or law. It was agreed that that matter could usefully be clarified in the commentary.

122. In addition, it was stated that no reference to contrary agreement of the parties was necessary in paragraph (3), since the right in the assigned receivable flowed from the contract and it was subject to party autonomy, which was recognized in a general way in draft article 13.

123. Subject to the changes mentioned in paragraphs 119 and 120 above, the Working Group adopted draft article 16 and referred it to the drafting group.

Article 19. *Debtor's discharge by payment*

124. The text of draft article 19 as considered by the Working Group was as follows:

"(1) Until the debtor receives notification of the assignment, the debtor is entitled to be discharged by paying in accordance with the original contract.

"(2) After the debtor receives notification of the assignment, subject to paragraphs (3) to (8) of this article, the debtor is discharged only by paying the assignee or as otherwise instructed.

"(3) If 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 first notification received.

"(4) If the debtor receives more than one payment instruction relating to a single assignment of the same receivables by the same assignor, the debtor is discharged by paying in accordance with the last payment instruction received from the assignee before payment.

"(5) If the debtor receives notification of one or more subsequent assignments, the debtor is discharged by paying in accordance with the notification of the last of such subsequent assignments.

"(6) If 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.

"(7) 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.

"[(8) This article does not affect any ground on which the debtor may be discharged by paying a person to whom an invalid assignment has been made.]"

125. With regard to paragraph (2), it was agreed that it should make clear that after notification the debtor could be discharged only by paying the assignee or, if otherwise instructed, in accordance with the payment instructions given by the assignee. As a matter of drafting, it was agreed that paragraphs (1) and (2) could be consolidated in one provision.

126. As to paragraph (6), it was noted that, if the payment obligation became due during the time when the assignee was expected to provide adequate proof and the debtor failed to pay, the debtor could be in default and become liable to damages and interest for late payment. It was also noted that the understanding of the Working Group so far had been that the payment obligation would be suspended. In order to avoid any uncertainty, it was suggested that the matter be addressed explicitly in paragraph (6) by providing either that the payment obligation should be suspended or that the debtor could be discharged by paying the assignor.

127. The suggestion to allow the debtor to discharge its obligation by paying the assignor was objected to on the grounds that: it would result in codifying a rule that would be inappropriate in principle; and it could lead to abuses by debtors acting in bad faith or in collusion with the assignor and waiting until payment became due before requesting adequate proof, so as to continue paying the assignor or to delay payment. Some support was expressed in favour of a suspension of payments. It was stated that a debtor, in particular if it were a consumer debtor, would be in a difficult position if faced with a notification from an unknown, foreign assignee. In such a situation, it was pointed out, the debtor would not have sufficient time to examine the notification, would be subject to payment of damages and interest, if it delayed payment, and would not be discharged, if it paid an assignee who was not an assignee (i.e. the assignment was null and void, e.g. for fraud or duress). In order to address those concerns, a number of suggestions were made. One suggestion was to limit the application of paragraph (6) to cases in which the debtor had legitimate doubts. Another suggestion was that the assignee should be qualified as a "purported" assignee. Yet another suggestion was to define adequate proof by reference solely to a writing emanating from the assignor.

128. The prevailing view, however, was that the matter should not be explicitly addressed in the text of the draft Convention. It was stated that explicitly stating in paragraph (6) that the debtor could pay the assignor or that the payment obligation could be suspended might inadvertently result in encouraging abusive practices. In addition, it was observed that, if the debtor were able to continue to make payment to the assignor, even if the assignor had become insolvent or had ceased to exist, the assignee would find itself at a significant disadvantage. As to the problem of fraudulent assignees, it was widely felt that it rarely occurred in practice and, in any case, was sufficiently addressed in paragraph (7), which allowed debtors to obtain a valid discharge by paying in accordance with their own national law.

129. As to paragraph (7), it was noted that it might inadvertently result in a debtor ignoring a notification given under the draft Convention (e.g. because it related to future receivables, which might not be allowed under other law) and paying someone else in accordance with other law. It was, therefore, suggested that the paragraph be amended to validate payment under other law only if it were made to a legitimate assignee under the draft Convention, while limiting recourse to payment into court.

130. It was widely felt, however, that such an approach would actually narrow the protection available to the

debtor. It was stated that paragraph (7) was originally intended to ensure that if, under other law apart from the draft Convention, there was a mechanism that would enable the debtor to obtain a discharge, the debtor should not be precluded from resorting to that mechanism.

131. As to paragraph (8), it was suggested that it should be deleted, since it either stated an obvious rule or placed on the debtor the risk of having to determine the validity of the assignment in order to obtain a valid discharge.

132. After discussion and subject to the consolidation of paragraphs (1) and (2), the change to paragraph (2) mentioned in paragraph 125 above and the deletion of paragraph (8), the Working Group adopted draft article 19 and referred it to the drafting group.

Article 20. *Defences and rights of set-off of the debtor*

133. The text of draft article 20 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 or rights of set-off arising from the original contract 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.

"(3) Notwithstanding paragraphs (1) and (2), defences and rights of set-off that the debtor could raise pursuant to article 10 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."

134. The Working Group considered the question whether rights of set-off arising from contracts between the assignor and the debtor that were closely related to the original contract (e.g. a maintenance or other service agreement supporting the original sales contract) should be treated in the same way as rights of set-off arising from the original contract (i.e. the debtor should be able to raise them against the assignee irrespective of whether they arose before or after notification). It was generally agreed that such rights of set-off should receive the same treatment under the draft Convention as rights arising from the original contract. It was also agreed that, in expressing such a notion of "close connection" in the draft Convention, attention should be given to avoiding a formulation that would cover too wide a range of contracts. Language along the following lines was proposed: "rights of set-off arising from the same transaction as the original contract".

135. It was noted that paragraph (2) referred to rights of set-off being "available" at the time of notification for the notification to cut off such rights of set-off. In order to dispel any uncertainties and disparities that might exist with respect to the law applicable to set-off, it was suggested that reference should be made to the law governing the original contract. That suggestion was objected to on the grounds that it would not be appropriate to attempt addressing in the draft Convention such a general private international law issue. The suggestion was also objected since the law governing the original contract might not be the appropriate law and would, in any case, fail to cover non-contractual grounds of set-off (see paras. 155-156).

136. Subject to the change referred to in paragraph 134 above, the Working Group adopted draft article 20 and referred it to the drafting group.

Article 21. *Agreement not to raise defences or rights of set-off*

137. The text of draft article 21 as considered by the Working Group was as follows:

"(1) Without prejudice to the law governing the protection of the debtor in transactions made primarily for personal, family or household purposes in the State in which the debtor is located, the debtor may agree with the assignor in a signed writing not to raise against the assignee the defences and rights of set-off that it could raise pursuant to article 20. 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.

"(3) Such an agreement may only be modified by an agreement in a signed writing. The effect of such a modification as against the assignee is determined by article 22 (2)."

138. It was noted that the reference to debtors in transactions for "personal, family or household purposes", contained in paragraph (1) (as well as in draft article 23), was qualified by the term "primarily", so as to ensure that the limitation would apply only to transactions for purely consumer purposes (i.e. transactions between consumers). It was widely felt, however, that, in order to be consistent with the purpose of protecting consumer debtors, that provision should apply to transactions serving consumer purposes with respect to one party and commercial purposes from the perspective of the other party (i.e. transactions between a consumer and a business entity).

139. It was also noted that paragraphs (1) and (3) referred to a signed writing, without clarifying whether the signature of the debtor only or both the debtor and the assignor was required. It was agreed that the provision should clarify that the writing needed to be signed only by the debtor, since the debtor was the party whose rights would be affected by a modification of an agreement to waive defences.

140. Subject to those changes, the Working Group adopted draft article 21 and referred it to the drafting group.

Article 22. *Modification of the original contract*

141. The text of draft article 22 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 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."

142. It was noted that paragraph (1) referred to notification, without clarifying whether it was effective when sent to or received by the debtor. The Working Group agreed that the relevant point of time was the time when notification was received by the debtor, since as of that time the debtor could discharge its obligation only in accordance with the assignee's payment instructions. Noting that the matter was addressed in draft article 18, the Working Group adopted draft article 22 unchanged.

Article 23. *Recovery of payments*

143. The text of draft article 22 as considered by the Working Group was as follows:

"Without prejudice to the law governing the protection of the debtor in transactions made primarily for personal, family or household purposes in the State in which the debtor is located and the debtor's rights under article 20, failure of the assignor to perform the original contract does not entitle the debtor to recover from the assignee a sum paid by the debtor to the assignor or the assignee."

144. Subject to the deletion of the word "primarily", the Working Group adopted draft article 23 and referred it to the drafting group (see para. 138).

Scope and purpose of chapter V

145. Differing views were expressed as to the scope or the purpose of the private international law rules of the draft Convention, a matter addressed in paragraph (3) of draft article 1, the text of which as considered by the Working Group was as follows:

"[(3) The provisions of chapter V 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] [independently of the provisions of this chapter]. However, those provisions do not apply if a State makes a declaration under article 34.]"

146. One view was that the application of chapter V should only supplement the substantive law provisions of the draft Convention and thus apply only to the transactions falling within the ambit of the draft Convention as defined in chapter I. In support of that view, it was stated that, from a legislative policy point of view, it would not be appropriate to attempt, in essence, to prepare a mini private international law convention within a substantive law convention. If chapter V were to supplement the substantive law provisions of the draft Convention, it was stated, it might be sufficient to retain only draft article 28 in section II of chapter IV with the opening words that appeared within square brackets. It was stated that, in such a case, draft article 28 could address matters not covered in the substantive law part of the draft Convention, such as the question of the law applicable to set-off and to statutory assignability, and would not need to be subject to an opt-out clause. In addition, it was pointed out that draft article 27 could be deleted, since it addressed the contractual aspects of assignment, namely a matter which was not the main focus of the draft Convention and might already be sufficiently regulated by private international law (even though the principle of freedom of choice of the applicable law might not be common to all legal systems). Moreover, it was observed that draft articles 29 to 31 could be deleted, since the matters addressed in those provisions were already sufficiently covered in draft articles 24 to 26. On the other hand, if chapter V were to be retained, it was suggested that it should be subject to an opt-in rather than an opt-out clause. That suggestion received significant support.

147. The Working Group noted that, in principle, it would not be appropriate to limit the application of private international law rules on the basis of the substantive law notions contained in chapter I (i.e. only to assignments as defined in draft article 2, or only to international transactions as defined in draft article 3 or only if the assignor or the debtor was located in a Contracting State).

148. However, in an effort to reach consensus, the view was expressed that the application of chapter V could be limited to international transactions as defined in chapter I, irrespective of whether the assignor or the debtor had their location in a Contracting State or the law governing the receivable was the law of a Contracting State (an approach which had a precedence in article 1 (3) of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit). In support of that view, it was pointed out that such an approach would allow States that did not have adequate private international law rules on assignments or no rules at all to benefit from the rules contained in chapter V. While it was admitted that those rules reflected general principles which would need to be supplemented by other principles of private international law, it was observed that, in their generality, the provisions of chapter V introduced rules that might be useful for many States and usefully clarified matters (e.g. priority issues) over which a great degree of uncertainty prevailed in private international law. In addition, it was stated that, once the priority rules in draft articles 24 to 26 had become generally acceptable, there was no substantive reason to limit their application on the basis of the substantive law notions contained in chapter I. As to States that had adequate rules on assignment, it was pointed out that they

could always opt out of chapter V. Those suggestions also received significant support, although some delegations favoured retention of draft articles 28 and 29 only.

149. After discussion, the Working Group was not able to reach agreement. It was, therefore, decided that paragraph (3) of article 1 should be revised along the following lines and be retained within square brackets:

"[(3) The provisions of chapter V 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. However, those provisions do not apply if a State makes a declaration under article 34.]"

It was also decided that the opening words in draft articles 27 and 28, as well as draft article 29 as a whole (with the exception of the opening words which could be deleted; see para. 160), should remain in square brackets, pending final determination of the issue of the scope of chapter V. Furthermore, the Working Group agreed that draft articles 30 and 31 raised questions that would need to be discussed further and decided that those provisions too should be placed within square brackets.

Article 27. *Law applicable to the contract of assignment*

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

"(1) [With the exception of matters which are settled in this Convention,] the contract of assignment is governed by the law expressly chosen by the assignor and the assignee.

"(2) 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 contract of assignment is presumed to be most closely connected with the State in which the assignor has its place of business. If the assignor has more than one place of business, reference is to be made to the place of business most closely connected to the contract. If the assignor does not have a place of business, reference is to be made to its habitual residence.

"(3) If the contract of assignment is connected with one State only, the fact that the assignor and the assignee have chosen the law of another State does not prejudice the application of the law of the State with which the assignment is connected if that law cannot be derogated from by contract."

151. In order to reflect more clearly the matters that should be subject to party autonomy, the Working Group decided to substitute for "the contract of assignment" the terms "the rights and obligations of the assignor and the assignee under the contract of assignment". A suggestion to also include a reference to the "conclusion and validity of the contract of assignment" was objected to on the grounds that those terms were not universally understood in the same way and their use could create uncertainty.

152. The Working Group also considered whether paragraphs (2) and (3) were necessary. It was noted that, if the thrust of draft article 27 was to recognize party autonomy without going into any detail, paragraph (2) might not be absolutely necessary, in particular in view of the fact that the transactions intended to be covered were likely to be negotiated by highly sophisticated parties who normally included a choice of law clause in their contracts. As to paragraph (3), it was noted that it might not be useful without any detailed rules as to the relevant connecting factors (e.g. characteristic performance under article 4 (2) of the Convention on the law Applicable to Contractual Obligations "the Rome Convention" with the fall-back position of article 4 (5) of the Rome Convention if the characteristic performance could not be determined). The prevailing view, however, was that paragraphs (2) and (3) reflected important rules that might not exist in all legal systems and should thus be retained.

153. Subject to the change mentioned in paragraph 151 above and to the final determination of the scope of chapter V, the Working Group adopted draft article 27 and referred it to the drafting group.

Article 28. *Law applicable to the rights and obligations of the assignee and the debtor*

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

"[With the exception of matters which are settled in this Convention,] the law governing the receivable to which the assignment relates determines its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and any question whether the debtor's obligations have been discharged."

155. The Working Group considered, once more, the issue of the law applicable to rights of set-off. It was noted that the general principle as to contractual rights of set-off was that they were governed by the law of the contract from which they arose. It was also noted that, in line with that approach, the law governing rights of set-off would be the same as the law governing the receivable, if such rights of set-off arose from the original contract, and different, if rights of set-off arose from another contract.

156. In support of addressing the question of the law applicable to rights of set-off, it was stated that such an approach would enhance certainty and could have a beneficial impact on the cost of credit, since rights of set-off arose often and were bound to increase the risk of non-payment by the debtor. However, it was stated that, in order to achieve that result, rights of set-off should be subjected to the law governing the receivable. In view of the difficulty of the matter and the lack of consensus as to the law applicable to set-off, the Working Group recalled and confirmed its decision not to address that matter (see para. 135).

157. The Working Group next considered the question whether draft article 28 should govern statutory assignability. It was noted that the application of the law governing

the receivable might not be appropriate in the case of statutory assignability. Such an approach could inadvertently result in allowing the assignor and the debtor to evade possible statutory limitations, which involved matters of mandatory law or public policy, by choosing a convenient law to govern the receivable.

158. The Working Group recalled its decision not to include any additional provisions in draft article 28 on the understanding that statutory limitations to assignability, which would normally flow from mandatory law, would be preserved under draft article 30 (A/CN.9/456, para. 117). However, upon reflection, the Working Group decided that draft article 28 should be limited to contractual assignability. Subject to that change and to the final determination of the scope of chapter V, the Working Group adopted draft article 28 and referred it to the drafting group.

Article 29. *Law applicable to conflicts of priority*

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

"[With the exception of matters which are settled in chapter IV:]

(a) 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;

(b) priority between an assignee and the assignor's creditors is governed by the law of the State in which the assignor is located;

(c) priority between an assignee and the insolvency administrator is governed by the law of the State in which the assignor is located;

[*(d)* if an insolvency proceeding is commenced in a State other than the State in which the assignor is located, any non-consensual right or interest which under the law of the forum would have priority over the interest of an assignee has such priority notwithstanding subparagraph *(c)*, but only to the extent that such priority was specified by the forum State in an instrument deposited with the depositary prior to the time when the assignment was made;]

(e) an assignee asserting rights under this article has no less rights than an assignee asserting rights under other law.]"

160. It was noted that draft article 29 appeared within square brackets since, if chapter V were to supplement the substantive law part of the draft Convention, draft article 29 would repeat the rules in draft articles 24 and 25 and should be deleted. It was also noted that, if chapter V were to apply whether or not the assignor or the debtor were located in a Contracting State, the opening words would not be necessary, since chapter V would apply to matters not addressed in the draft Convention, while draft articles 24 and 25 would apply to matters addressed in the draft Convention. Subject to that change, the alignment of draft article 29 with draft articles 24 and 25 and the final determination of the scope of chapter V, the Working Group adopted draft article 29 and referred it to the drafting group.

Article 30. *Mandatory rules*

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

"(1) Nothing in articles 27 and 28 restricts the application of the rules of the law of the forum State in a situation where they are mandatory irrespective of the law otherwise applicable.

"(2) Nothing in articles 27 and 28 restricts the application of the mandatory rules of the law of another State with which the matters settled in those articles have a close connection if and in so far as, under the law of that other State, those rules must be applied irrespective of the law otherwise applicable."

162. Pending final determination of the scope of chapter V (see paras. 145-149) , the Working Group decided that draft article 30 should be retained within square brackets.

Article 31. *Public policy*

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

"With regard to matters settled in this chapter, the application of a provision of the law specified in this chapter may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State."

164. Pending final determination of the scope of chapter V (see paras. 145-149), the Working Group decided that draft article 31 should be retained within square brackets.

IV. ANNEX TO THE DRAFT CONVENTION

A. *General comments*

165. It was noted that the annex could be replaced by two provisions along the following lines:

"Article X. *Revision and amendment*

"1. At the request of not less than one third of the Contracting States to this Convention, the depositary shall convene a conference of the Contracting States for revising or amending it.

"2. Any instrument of ratification, acceptance, approval or accession deposited after the entry into force of an amendment to this Convention is deemed to apply to the Convention as amended.

"Article Y. *Revision of the priority regime*

"1. Notwithstanding the provisions of article X, a conference of Contracting States only for the purpose of establishing an international regime for the public filing of notices to address issues of priority arising in the context of assignment of receivables under this Convention is to be convened by the depositary in accordance with paragraph 2 of this article.

"2. A revision conference is to be convened by the depositary when not less than one fourth of the Contracting States so request. The depositary shall request all Contracting States invited to the conference to submit such proposals as they may wish the conference to examine and shall notify all Contracting States invited of the provisional agenda and of all the proposals submitted.

"3. Any decision by the conference must be taken by a two-thirds majority of the participating States. The conference may adopt all measures necessary to establish an effective international regime for the public filing of notices to address priority issues arising in the context of the assignment of receivables under this Convention. No State shall be bound to participate directly or indirectly in the international regime so established.

"4. Any amendment adopted is communicated by the depositary to all the Contracting States for acceptance and to all the States signatories of the Convention for information. Such amendment enters into force on the first day of the month following one year after its acceptance by two thirds of the Contracting States. Acceptance is to be effected by the deposit of a formal instrument to that effect with the depositary.

"5. After entry into force of an amendment a Contracting State which has accepted the amendment is entitled to apply the Convention as amended in its relations with Contracting States which have not within six months after the adoption of the amendment notified the depositary that they are not bound by the amendment.

"6. Any instrument of ratification, acceptance, approval or accession deposited after the entry into force of an amendment to this Convention is deemed to apply to the Convention as amended."

166. It was generally agreed that the annex should be retained, since it could provide States with some guidance as to a substantive law priority regime. As to the registration regime envisaged in the annex, it was stated that it could enhance certainty as to rights of financiers, thus reducing the risks and the costs involved in financing transactions. With regard to draft articles X and Y, it was stated that draft article X would be better placed in the final clauses, while draft article Y paragraph (3) could be retained either in the final provisions or in draft article 3 of the annex, perhaps with a more flexible formulation, which would not refer to a diplomatic conference. In response to a question, it was noted that, under draft article 36, States could choose one or none of the options offered in the annex (see paras. 188-191 and 203). The Working Group proceeded to consider the substantive rules contained in the draft annex.

B. *Discussion of draft articles of the annex*

Section I. Priority rules based on registration

Article 1. *Priority among several assignees*

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

"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."

168. The Working Group was agreed that the registry meant in draft article 1 of the annex was a notice and not a document registry, in the sense that only certain information about the assignment needed to be registered and not the document of the assignment as a whole. It was widely felt that, for the operation of the registration system to be quick, simple and inexpensive, it would need to be based on registration of a limited amount of data. As a matter of drafting, a number of suggestions were made, including that reference should be made to "data", "notice" or "document". The suggestion to refer to "document of assignment" was objected to on the ground that it could inadvertently give the impression that a document-filing system was involved. Subject to that change, the Working Group adopted draft article 1 of the annex and referred it to the drafting group.

Article 2. *Priority between the assignee and the insolvency administrator or the creditors of the assignor*

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

"[Subject to articles 25 (3) and (4) of this Convention and 4 of this annex,] 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."

170. As to the opening words, the Working Group decided that they should be deleted on the understanding that an explicit reference to the preservation of super-priority rights dealt with in draft article 25 (5) would be included in draft article 2 of the annex. That matter was referred to the drafting group. It was stated, however, that the opening words would not be necessary if the annex were to include an explicit statement to the effect that, should a State choose a system of priority rules based on sections I and II of the annex, draft articles 1 and 2 of the annex would operate as the priority rule for that State. The Working Group postponed discussion of that matter until it had completed its review of the annex (see paras.188-191). As to subparagraph *(a)*, the Working Group decided to retain the first set of bracketed words without the square brackets and to delete the second and third sets of bracketed words. The Working Group also decided to delete subparagraph *(b)*. It was recalled that that provision was part of a previous substantive law priority rule contained in the draft Convention that did not belong in draft article 2 of the annex since draft article 2 of the annex would be the sole basis on which an assignee could assert priority. Subject to those changes, the Working Group adopted draft article 2 of the annex and referred it to the drafting group.

Section II. Registration

Article 3. *Establishment of a registration system*

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

"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."

172. Support was expressed in favour of the policy underlying draft article 3. A number of suggestions were made. One suggestion was that the words "the exact manner" be replaced by the words "in detail" so as to avoid creating the impression that the regulations might need to be more detailed than was practically necessary and to give sufficient flexibility to the registrar and the supervising authority in preparing the regulations. Those suggestions received sufficient support. The suggestion was also made that draft article 3 needed to be more detailed in describing the registrar and the supervising authority. The Working Group postponed discussion of that matter until it had completed its review of the annex (due to the lack of sufficient time, the Working Group did not discuss that matter; see, however, the suggestion contained in para. 166). Subject to those changes, the Working Group adopted draft article 3 of the annex and referred it to the drafting group.

Article 4. *Registration*

173. The text of draft article 4 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 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."

174. As to paragraph (1), the concern was expressed that allowing "any person" to register data with regard to an assignment might open the possibility of abuse and fraudulent registration. In order to address that concern, the suggestion was made that the basis on which a person might register data should be qualified. It was stated, however, that fraudulent registration did not pose a real problem, since registration under draft article 4 did not create any substantive rights. It was generally felt, however, that reference should be made to persons specified in the regulations. Language along the following lines was proposed: "any person authorized by the regulations". In order to accommodate electronic registration and to allow registration to function in a multilingual environment, it was agreed that the reference to "name and address" should be replaced by a reference to identification. It was stated that the regulations could provide that a person could be identified with a number and that more data than the identification of the parties and the assigned receivables might be required. It was also agreed that paragraph (1) should provide also for registration of any amendments.

175. With regard to paragraph (2) *(b)*, the suggestion was made that it should be deleted. In support, it was stated that allowing registration of an assignment before it was made ("advance booking") could lead to abuses. That suggestion was objected to. It was widely felt that the ability to register a future assignment was at the heart of significant transactions. In the absence of certainty as to priority, it was observed, financiers would not enter into such transactions. It was also said that the risk of abusive registration practices developing was not real, since registration did not vest any rights in the registering party, unless such rights existed under a valid contract.

176. As to paragraph (3), it was agreed that it should permit a choice of the length of time of effectiveness from a range of options to be set out in the regulations. It was also agreed that at the end of paragraph (3) language along the following lines should be included: "and, consistent with this annex, such other matters as are necessary for the operation of the registration system".

177. Support was expressed in favour of the policy underlying paragraph (4) that an error with regard to the identification of the assignor was so essential that it would render the registration ineffective. It was stated that paragraph (4) was based on the assumption that: if the error was made by the registering party, the registering party would suffer the consequences of the registration being ineffective; and that, if the error was made by the registrar, the regulations would address the issue of liability. It was also suggested that in the first line of paragraph (4), the word "result" should be replaced by the words "would result" to indicate that, even if no one was actually misled, the registration would be ineffective.

178. Subject to the changes mentioned above, the Working Group adopted draft article 4 of the annex and referred it to the drafting group.

Article 5. *Registry searches*

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

"(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."

180. It was generally agreed that draft article 5 should make it clear that a public registry was meant and, for that reason, the use of the term "any person" in draft article 5 (1) was appropriate as reflecting the principle of public access to the registry for searching as opposed to registration purposes. In response to a concern expressed that the term "any person" might be too broad and undermine the confidentiality necessary in financing transactions, it was stated that that problem would not arise in view of the fact that registration would involve only a limited amount of data specified in draft article 4 of the annex and in the regulations and would not include information relating to the financial details of the transaction.

Section III. Priority rules based on the time of the contract of assignment

Article 6. *Priority among several assignees*

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

"(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."

182. There was sufficient support in the Working Group for the rule reflected in paragraph (1). As a matter of drafting, it was suggested that paragraph (1) should refer to several assignments of the same receivables by the same assignor.

183. With regard to paragraph (2), differing views were expressed as to whether the reference to "bad faith" would cover knowledge or notice of a previous assignment. One view was that, in line with current law in many legal systems, paragraph (2) would apply to cases in which the assignee had knowledge or notice of a previous assignment. Another view was that, in line with the decision of the Working Group that mere knowledge or notice should not affect the debtor's discharge, it should not affect the priority position of the assignee either. It was stated that the scope of paragraph (2) should be limited to cases of fraud or collusion. A related view was that, in its current formulation, paragraph (2) could not apply in the case of a second-in-time assignee who might lose its priority position on the grounds that it had knowledge or notice of a previous assignment because it referred to the earliest assignee losing its priority if it were in bad faith and because knowledge or notice of a previous assignment was not relevant to priority in the case of a first-in-time of assignment priority rule. It was, therefore, pointed out that, if the scope of paragraph (2) was limited to cases involving fraud, it might not be necessary, since such matters were likely to be covered sufficiently in most legal systems. It was also stated that, in the case of fraud, there might be no conflict of priority to which paragraph (2) could apply, since the assignment would be set aside as a fraudulent conveyance. After discussion, the Working Group decided to delete paragraph (2) on the understanding that questions of good faith were left to law applicable outside the draft Convention (as to the application of the principle of good faith under the draft Convention, see A/CN.9/WG.II/WP.105, para. 62).

184. As to paragraph (3), there was agreement that it reflected an inappropriate rule and should be deleted. The Working Group also decided to delete paragraph (4) on the understanding that the commentary would explain that the important question of who had the burden of proof was left to other law applicable outside the draft Convention.

185. After discussion, subject to the changes mentioned above, the Working Group adopted draft article 6 of the annex and referred it to the drafting group.

Article 7. *Priority between the assignee and the insolvency administrator or the creditors of the assignor*

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

"[Subject to articles 25 (3) and (4) of this Convention,] 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."

187. As to the opening words, the Working Group decided that they should be deleted on the understanding that a reference should be included to the preservation of superpriority rights dealt with in draft article 25 (5). That matter was referred to the drafting group (as to the need for the addition of a reference to draft article 25 (5), see paras. 170 and 188-191). The question was raised whether reference should be added to the rights of the insolvency administrator or the assignor's creditors that should be preserved on

the grounds that they were based on mandatory law. In response, it was stated that draft article 25 (4) had been deleted on the understanding that priority did not cover those matters and that they were left to the law applicable outside the draft Convention. It was agreed that that matter should be clarified in the commentary. In line with its decision on draft article 2 of the annex (see para. 170), the Working Group decided that subparagraph *(b)* should be deleted.

C. *Proposal as to the application of the annex*

188. It was pointed out that, under the current formulation of draft article 36, it was contemplated that a State could choose the priority rules of section I and the registration system of section II. The view was expressed that there should be two additional alternatives: a State should be able to choose the priority rules of section I and a registration system other than that proposed in section II, or, alternatively, the registration system of section II and priority rules other than those proposed in section I. It was suggested that those three alternatives should be set out in a new draft article.

189. It was also suggested that an explicit statement should be included in a new draft article to the effect that, should a State choose a system of priority rules based on sections I and II of the annex, the priority rules under draft article 1 of the annex would operate as the priority rules for that State under draft article 24 of the draft Convention.

190. On the basis of those suggestions, language along the following lines was proposed for a new article:

"(1) A Contracting State may:

(a) (i) accept the priority rules based on registration set out in section I of this annex and (ii) choose to participate in the registration system established pursuant to section II of this annex; or

(b) (i) accept the priority rules based on registration set out in section I of this annex and (ii) agree to effectuate such rules by use of a registration system that fulfils the purposes of such rules [as set forth in regulations promulgated pursuant to section II]. For purposes of section I, registration pursuant to such system shall have the same effect as registration pursuant to section II.

"(2) For purposes of article 24, the law of a Contracting State that has acted pursuant to paragraph (1) *(a)* or (1) *(b)* is the set of rules set forth in section I of this annex. The Contracting State is entitled to apply those rules for all assignments made more than six months after the Contracting State notifies the depositary that it is has so acted. The Contracting State may establish rules pursuant to which assignments made before the effective date shall, within a reasonable time, become subject to the priority rules set forth in section I of this annex.

"(3) A Contracting State that does not act pursuant to paragraph (1) *(a)* or (1) *(b)* may, pursuant to its domestic priority rules, utilize the registration system established pursuant to section II of this annex."

191. Due to the lack of time, the Working Group was not able to discuss the proposed new article. It was stated, however, that the rule in paragraph (2) should apply also in the case where a State chose the priority rules set forth in section III of the annex. Subject to that change, the Working Group decided that the proposed new article should be introduced in the text of the draft Convention within square brackets. The specific formulation and the placement of the proposed new article in the text of the draft Convention were referred to the drafting group.

V. FINAL PROVISIONS OF THE DRAFT CONVENTION

Article 33. *Conflicts with international agreements*

192. The text of draft article 33 as considered by the Working Group was as follows:

"(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) A State may declare at any time that the Convention will not prevail over international conventions or other multilateral or bilateral agreements listed in the declaration, which it has entered or will enter into and which contain provisions concerning the matters governed by this Convention."

193. It was noted that, at its twenty-ninth session, the Working Group had adopted draft article 33 in order to deal with situations in which various texts gave precedence to each other and, as a result, uncertainty arose as to which one was applicable ("negative conflicts", e.g. with the Ottawa Convention; see A/CN.9/455, paras. 126-129). It was also noted, however, that potential conflicts with the Ottawa Convention were minimal, since the scope of the Ottawa Convention was narrower than the scope of the draft Convention and, in any case, the provisions of the draft Convention were, to a large extent, similar to those of the Ottawa Convention (with the exception, e.g. of the reservation to the rule on contractual limitations to assignment and the rule on recovery from the assignee of payments made by the debtor). Furthermore, it was noted that potential conflicts with the Rome Convention were also minimal since draft articles 27 and 28 were almost identical with article 12 of the Rome Convention or the relevant provisions of other texts, such as the Inter-American Convention on the Law Applicable to Contractual Obligations ("the Inter-American Convention"). As to the law governing priority, it was noted that, according to the prevailing view, article 12 of the Rome Convention did not address that matter. However, it was noted, even if draft article 12 of the Rome Convention addressed issues of priority, neither of the laws applicable under article 12 (i.e. the law chosen by the parties or the law governing the receivable) was appropriate. It was also noted that no conflicts arose with the draft EU Insolvency Convention (which was likely to be issued as an EU regulation). The notion of central administration was almost identical with the centre of main

interests used in the draft EU Insolvency Convention and that draft Convention did not affect rights in rem in a main insolvency proceeding. While it was noted that the draft EU Insolvency Convention might affect rights in rem in a secondary insolvency proceeding (articles 2 *(g)*, 4, and 28), draft article 25 would be sufficient to preserve, for example, super-priority rights, and priority under the draft Convention was not intended to affect the rights of the assignor's creditors and the insolvency administrator to invalidate the assignment as a fraudulent or preferential transfer.

194. It was stated that, according to general principles of treaty law, the draft Convention would not prevail over the Ottawa Convention on the grounds that the Ottawa Convention was a more specific convention. It was also observed that, according to the same principles, the draft Convention would not prevail over the draft EU Insolvency Convention, the draft Convention on International Interests in Mobile Equipment, the United Nations Convention on Independent Guarantees and Stand-By Letters of Credit or the Convention on the International Recognition of Rights in Aircraft. On the other hand, it was stated that the draft Convention would prevail over the Rome Convention or the Inter-American Convention, since substantive law conventions prevailed over private international law conventions.

195. It was widely felt, however, that draft article 33 departed from generally acceptable principles as to conflicts among international texts, in particular in that it would result in the draft Convention superseding even future conventions. It was, therefore, agreed that a provision along the lines of article 90 of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980; "the United Nations Sales Convention") which gave precedence to other texts, properly adjusted as to territorial connection, would be more appropriate. As a result of that decision, the Working Group agreed that paragraph (2) and new paragraph (3) (see paras. 88-91) were unnecessary and should be deleted.

Article 34. *Application of chapter V*

196. The text of draft article 34 as considered by the Working Group was as follows:

> "A State may declare at any time that it will not be bound by chapter V."

197. It was noted that the Working Group, at its twenty-ninth session, had adopted the working assumption that chapter V would be subject to a reservation by States (A/CN.9/455, paras. 72 and 148). The Working Group recalled the suggestions made at the current session that chapter V should be rather subject to an opt-in clause and decided that that matter should be left to the Commission.

Article 35. *Other exclusions*

198. The text of draft article 35 as considered by the Working Group was as follows:

> "[A State may declare at any time that it will not apply the Convention to certain practices listed in a declaration.]"

199. It was stated that allowing States to exclude further practices would make the draft Convention more acceptable to States that might be concerned with the application of the draft Convention to certain practices. It was also observed that the Working Group made significant progress in addressing such concerns by allowing States to make a reservation with regard to Government receivables. However, it was pointed out that the question whether draft article 35 would be necessary could not be answered before the final determination of the scope of the draft Convention and in particular before a final decision had been reached on the treatment of the assignment of financial receivables. On the other hand, it was observed that an approach based on declarations would detract from the certainty achieved by the draft Convention, since its scope of application could be different from State to State, a matter that might not be easy to determine in each particular case.

200. In the discussion, a number of suggestions were made. One suggestion was made that the term "specific" should be substituted for the term "certain" practices. Another suggestion was that reference should be made to the debtor's location with respect to the application of those provisions of the draft Convention that affected the debtor's rights and obligations. Yet another suggestion was that the exception as to sovereign receivables should be placed right after draft article 35.

201. After discussion, the Working Group decided that draft article 35 should be retained within square brackets and referred it to the drafting group.

Article 36. *Application of the annex*

202. The text of draft article 36 as considered by the Working Group was as follows:

> "A State may declare at any time that it will be bound either by [sections I and II or by section III] of the annex to this Convention."

203. It was agreed that draft article 36 should be aligned with the new article proposed to describe the options that States would have in making a declaration with respect to the annex and the effect of such declarations (see paras. 188-191). In view of the fact that the Working Group did not have the time to discuss the proposed new article dealing with that matter, it was also agreed that the options should be retained within square brackets. With that understanding, the Working Group referred draft article 36 to the drafting group.

Article 37. *Insolvency rules or procedures not affected by this Convention*

204. The text of draft article 37 as considered by the Working Group was as follows:

> "[A State may declare at any time that other rules or procedures governing the insolvency of the assignor shall not be affected by this Convention.]"

205. It was noted that draft article 37 related to matters addressed in draft article 25 (4). The Working Group recalled its decision to delete that provision and decided that draft article 37 also should be deleted.

Provisions for the transitional application of the draft Convention

206. The Working Group agreed that draft articles 40 (5), 42 (3) and 43 (3), which dealt with the effects of declarations, of the entry into force and of the denunciation of the draft Convention on rights of third parties, on transactions existing before the entry into force of the draft Convention and on transactions existing before denunciation respectively should be retained within square brackets for States to consider in their preparation for the next Commission session. As to draft article 42 (3), the concern was expressed that it might inappropriately restrict the sovereign right of States to denounce the draft Convention. In response, it was stated that draft article 42 (3) stated an important principle and, in the absence of a provision along the lines of draft article 42 (3), parties would be reluctant to enter into such transactions, a result that was said to be inconsistent with the main goal of the draft Convention.

Revision and amendment

207. The Working Group considered a provision dealing with revision and amendment of the draft Convention, which had been prepared by the secretariat and was as follows:

"Article X. *Revision and amendment*

"1. At the request of not less than one third of the Contracting States to this Convention, the depositary shall convene a conference of the Contracting States for revising or amending it.

"2. Any instrument of ratification, acceptance, approval or accession deposited after the entry into force of an amendment to this Convention is deemed to apply to the Convention as amended."

208. It was noted that the provision was based on article 32 of the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules). It was stated, however, that, in view of the budgetary restrictions under which the secretariat had to operate, the holding of a diplomatic conference should be left to the discretion of the depositary. It was, therefore, suggested that the words "may within existing resources" should be substituted for the word "shall". That suggestion was objected to on the grounds that, in its current formulation, draft article X reflected normal practice. In view of the lack of sufficient time to discuss that matter, the Working Group decided that draft article X should not be included in the text of the draft Convention, leaving that matter to the Commission.

VI. REPORT OF THE DRAFTING GROUP

209. The Working Group requested a drafting group established by the secretariat to review draft articles 1 (3), 2 to 5, 8, 10 to 12, 16, 19 to 29 and 33 to 42 of the draft Convention, as well as draft articles 1 to 7 of the annex to the draft Convention, with a view to ensuring consistency between the various language versions.

210. At the close of its deliberations, the Working Group considered the report of the drafting group and adopted draft articles 1(3), 2 to 5, 8, 10 to 12, 16, 19 to 29, 33 to 42 of the draft Convention and draft articles 1 to 7 of the annex to the draft Convention, as revised by the drafting group, as well as the rest of the draft articles of the draft Convention. The consolidated text of the draft Convention, as adopted by the Working Group, is reproduced in the annex to the present report.

211. Given that the new provision dealing with conflicts with other international agreements remained in brackets, it was agreed that paragraph (2) of draft article 4 also should remain in brackets. It was suggested that the title to draft article 5 should be revised to read only "definitions" as principles of interpretation were to be found elsewhere in the draft Convention. In response, it was noted that the title of draft article 5 had been adopted at the previous session of the Working Group and had not been considered by the drafting group at the current session. It was agreed that the bracketed text in variant B of subparagraph *(j)* (ii) of draft article 5 (see paras. 96-97) should be deleted. It was also agreed that, throughout subparagraphs *(a)* to *(c)* of draft article 16 (1), the appropriate term should be "in respect of". Furthermore, it was agreed that in draft article 19 the term "receivables" should be changed to "receivable" in the singular, for the sake of consistency. Concerning draft article 20, it was agreed that in paragraph (1) the reference should be to any other contract that "was" part of the same transaction, and that paragraph (3) should refer to defences and rights of set-off that the debtor "may raise". As to draft article 21, the reference in paragraph (1) was changed to "a writing signed by the debtor" for consistency with paragraph (3).

212. The concern was expressed that draft article 24 went beyond covering priority in receivables and proceeds and was, therefore, inconsistent with the policy decision of the Working Group. In response, it was noted that, while it was true that the issue of the extent and existence of an assignee's, as well as an inventory financier's, right in receivables and proceeds had not been discussed in any detail, it had been mentioned in the discussion. It was also noted that, responding to a query by the secretariat, the Working Group had confirmed that those matters should be covered, although they had not been discussed. As to draft article 24, it was suggested that the title should read "Law applicable to competing rights of other parties".

213. With regard to paragraph (2) of new draft article 26, it was agreed that it was necessary to specify that the assignee's "right" had priority over the right in the assigned receivable. The view was expressed that the whole of chapter V of the draft Convention should be retained in brackets. It was felt, however, that the report of the Working Group would adequately reflect the discussions that had been held concerning this chapter. As to draft article 27, the reference in paragraph (2) was changed to the habitual residence "of the assignor", and the language in paragraph (3) was changed to refer "to the extent" that law cannot be derogated from by contract. In line with its decision made after the preparation of the report of the drafting group (see para. 195), the Working Group agreed that new paragraph (3) of draft article 33 (see paras. 88-91) should be deleted

and paragraphs (1) and (2) should be revised to conform with the standard provisions for resolving conflicts with other international agreements that would be found in other international conventions, such as the United Nations Sales Convention. In response to a question raised, it was noted that the matter of the use of the term "data" or some other term in draft article 1 of the annex had been left to the drafting group, on the understanding that any term used should reflect the policy decision of the Working Group in favour of a notice-filing rather than a document-filing system. In respect of draft article 4 of the annex, it was suggested that: in paragraph (1), the term "assigned" should be replaced with "covered" to ensure that the description referred also to future receivables; in subparagraph (2) *(b)*, reference should be to an assignment "not yet concluded"; in paragraph (3), reference should be to a registration having been "extended", rather than "renewed"; and in paragraph (4), reference should be to the "correct" identification of the assignor. Those suggestions were objected to. It was widely felt that the language as prepared by the drafting group was satisfactory.

214. It was agreed that the latter part of new draft article 36 (see annex to this report), starting with the word "provided", should be placed within square brackets, so as to indicate that the matter addressed therein would need to be discussed further. It was also agreed that new draft articles 40 (3), 41 (5) and 43 (3) (see annex to this report) should be placed within square brackets so as to indicate that the issues addressed therein would need to be examined carefully and discussed further.

VII. FUTURE WORK

215. The Working Group noted that issues, such as the meaning of "location", the special regime with regard to financial receivables and the scope of the private international law provisions of the draft Convention, remained pending. However, on the understanding that such issues could only be resolved by the Commission, the Working Group decided to complete its work with the adoption of the draft Convention as a whole and to submit it to the Commission at its next session for final review and adoption (New York, 12 June to 7 July 2000). It was noted that the text of the draft Convention, as adopted by the Working Group, would be distributed to all States and interested international organizations for comments and that the secretariat would prepare an analytical compilation of those comments. It was also noted that the secretariat would finalize and distribute the commentary to the draft Convention. It was expected that the compilation of comments and the commentary would assist delegates at the Commission session in their deliberations and allow the Commission to finalize and adopt the draft Convention.

ANNEX I

Consolidated text of the draft Convention:

DRAFT CONVENTION ON ASSIGNMENT [IN RECEIVABLES FINANCING] [OF RECEIVABLES IN INTERNATIONAL TRADE]

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 content and choice of legal regime applicable to assignments [of receivables] in international trade [constitute an obstacle to financing transactions],

Desiring to establish principles and adopt rules [relating to the assignment of receivables] that would create certainty and transparency and promote modernization of law relating to [assignments of receivables] [receivables financing] [including but not limited to assignments used in factoring, forfaiting, securitization, project financing, and refinancing,] while protecting existing [financing] [assignment] practices and facilitating the development of new practices,

Also desiring to ensure the adequate protection of the interests of the debtor in the case of an assignment of receivables,

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

Have agreed as follows:

CHAPTER I. SCOPE OF APPLICATION

Article 1. *Scope of application*

(1) This Convention applies to:

(a) assignments of international receivables and to international assignments of receivables as defined in this chapter, if, at the time of the conclusion of the contract of assignment, the assignor is located in a Contracting State;

(b) subsequent assignments provided that any prior assignment is governed by this Convention; and

(c) subsequent assignments that are governed by this Convention under subparagraph *(a)* of this paragraph, notwithstanding that any prior assignment is not governed by this Convention.

(2) This Convention does not affect the rights and obligations of the debtor unless the debtor is located in a Contracting State or the law governing the receivable is the law of a Contracting State.

[(3) The provisions of chapter V 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. However, those provisions do not apply if a State makes a declaration under article 37.]

(4) The annex to this Convention applies in a Contracting State which has made a declaration under article 36.

Article 2. *Assignment of receivables*

For the purposes of this Convention:

(a) "assignment" means the transfer by agreement from one person ("assignor") to another person ("assignee") of the assignor's contractual right to payment of a monetary sum ("receivable") from a third person ("the debtor"). The creation of rights in receivables as security for indebtedness or other obligation is deemed to be a transfer;

(b) in the case of an assignment by the initial or any other assignee ("subsequent assignment"), the person who makes that assignment is the assignor and the person to whom that assignment is made is the assignee.

Article 3. *Internationality*

A receivable is international if, at the time of the conclusion of the original contract, the assignor and the debtor are located in different States. An assignment is international if, at the time of the conclusion of the contract of assignment, the assignor and the assignee are located in different States.

Article 4. *Exclusions*

(1) This Convention does not apply to assignments:

(a) made to an individual for his or her personal, family or household purposes;

(b) to the extent made by the delivery of a negotiable instrument, with any necessary endorsement;

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

[(2) This Convention does not apply to assignments listed in a declaration made under article 39 by the State in which the assignor is located, or with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, by the State in which the debtor is located.]

[Article 5. *Limitations on receivables other than trade receivables*

Variant A

(1) Articles 17, 18, 19, 20 and 22 do not affect the rights and obligations of the debtor in respect of a receivable other than a trade receivable except to the extent the debtor consents.

(2) Notwithstanding articles 11 (2) and 12 (3), an assignor who assigns a receivable other than a trade receivable is not liable to the debtor for breach of a limitation on assignment described in articles 11 (1) and 12 (2), and the breach shall have no effect.

Variant B

Articles 11 and 12 and section II of chapter IV apply only to assignments of trade receivables. With respect to assignments of receivables other than trade receivables, the matters addressed by these articles are to be settled in conformity with the law applicable by virtue of the rules of private international law.]

CHAPTER II. GENERAL PROVISIONS

Article 6. *Definitions and rules of interpretation*

For the purposes of this Convention:

(a) "original contract" means the contract between the assignor and the debtor from which the assigned receivable arises;

(b) "existing receivable" means a receivable that arises upon or before the conclusion of the contract of assignment; "future receivable" means a receivable that arises after the conclusion of the contract of assignment;

[*(c)* "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;]

(d) "writing" means any form of information that is accessible so as to be usable for subsequent reference. Where this Convention requires a writing to be signed, that requirement is met if, by generally accepted means or a procedure agreed to by the person whose signature is required, the writing identifies that person and indicates that person's approval of the information contained in the writing;

(e) "notification of the assignment" means a communication in writing which reasonably identifies the assigned receivables and the assignee;

(f) "insolvency administrator" means a person or body, including one appointed on an interim basis, authorized in an insolvency proceeding to administer the reorganization or liquidation of the assignor's assets or affairs;

(g) "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 or other competent authority for the purpose of reorganization or liquidation;

(h) "priority" means the right of a party in preference to another party;

(i) (i) a person is located in the State in which it has its place of business;

(ii) if the assignor or the assignee has more than one place of business, the place of business is that place where its central administration is exercised;

(iii) if the debtor has more than one place of business, the place of business is that which has the closest relationship to the original contract;

(iv) if a person does not have a place of business, reference is to be made to the habitual residence of that person;

(j) "law" means the law in force in a State other than its rules of private international law;

(k) "proceeds" means whatever is received in respect of an assigned receivable, whether in total or partial payment or other satisfaction of the receivable. The term includes whatever is received in respect of proceeds. The term does not include returned goods;

[*(l)* "trade receivable" means a receivable arising under an original contract for the sale or lease of goods or the provision of services other than financial services.]

Article 7. *Party autonomy*

The assignor, the assignee and the debtor may derogate from or vary by agreement provisions of this Convention relating to their respective rights and obligations. Such an agreement does not affect the rights of any person who is not a party to the agreement.

Article 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.

CHAPTER III. EFFECTS OF ASSIGNMENT

Article 9. *Effectiveness of bulk assignments, assignments of future receivables, and partial assignments*

(1) An assignment of existing or future, one or more, receivables, and parts of, or undivided interests in, receivables is effective, whether the receivables are described:

(a) individually as receivables to which the assignment relates; or

(b) in any other manner, provided that they can, at the time of the assignment or, in the case of future receivables, at the time of the conclusion of the original contract, be identified as receivables to which the assignment relates.

(2) Unless otherwise agreed, an assignment of one or more future receivables is effective at the time of the conclusion of the original contract without a new act of transfer being required to assign each receivable.

Article 10. *Time of assignment*

An existing receivable is transferred, and a future receivable is deemed to be transferred, at the time of the conclusion of the contract of assignment, unless the assignor and the assignee have specified a later time.

Article 11. *Contractual limitations on assignments*

(1) An assignment of a receivable is effective notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee, 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 for breach of such an agreement. A person who is not party to such an agreement is not liable on the sole ground that it had knowledge of the agreement.

Article 12. *Transfer of security rights*

(1) A personal or property right securing payment of the assigned receivable is transferred to the assignee without a new act of transfer, unless, under the law governing the right, it is transferable only with a new act of transfer. If such a right, under the law governing it, is transferable only with a new act of transfer, the assignor is obliged to transfer this right and any proceeds to the assignee.

(2) A right securing payment of the assigned receivable is transferred under paragraph (1) of this article notwithstanding an agreement between the assignor and the debtor or other person granting the right, limiting in any way the assignor's right to assign the receivable or the right securing payment of the assigned receivable.

(3) Nothing in this article affects any obligation or liability of the assignor for breach of an agreement under paragraph (2) of this article. A person who is not a party to such an agreement is not liable on the sole ground that it had knowledge of the agreement.

(4) 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.

(5) 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 receivable.

CHAPTER IV. RIGHTS, OBLIGATIONS AND DEFENCES

Section I. Assignor and assignee

Article 13. *Rights and obligations of the assignor and the assignee*

(1) The rights and obligations of the assignor and the assignee as between them 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 14. *Representations of the assignor*

(1) Unless otherwise agreed between the assignor and the assignee, the assignor represents at the time of the conclusion 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 15. *Right to notify the debtor*

(1) Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor

a notification of the assignment and a payment instruction, but after notification is sent only the assignee may send a payment instruction.

(2) A notification of the assignment or payment instruction sent in breach of any agreement referred to in paragraph (1) of this article is not ineffective for the purposes of article 19 by reason of such breach. 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.

Article 16. *Right to payment*

(1) As between the assignor and the assignee, unless otherwise agreed, and whether or not a notification of the assignment has been sent:

(a) if payment in respect of the assigned receivable is made to the assignee, the assignee is entitled to retain the proceeds and goods returned in respect of the assigned receivable;

(b) if payment in respect of the assigned receivable is made to the assignor, the assignee is entitled to payment of the proceeds and is also entitled to goods returned to the assignor in respect of the assigned receivable; and

(c) if payment in respect of the assigned receivable is made to another person over whom the assignee has priority, the assignee is entitled to payment of the proceeds and is also entitled to goods returned to such person in respect of the assigned receivable.

(2) The assignee may not retain more than the value of its right in the receivable.

Section II. Debtor

Article 17. *Principle of debtor-protection*

(1) Except as otherwise provided in this Convention, an assignment does not, without the consent of the debtor, affect the rights and obligations of the debtor, including the payment terms contained in the original contract.

(2) A payment instruction may change the person, address or account to which the debtor is required to make payment, but may not:

(a) change the currency of payment specified in the original contract, or

(b) change the State specified in the original contract, in which payment is to be made, to a State other than that in which the debtor is located.

Article 18. *Notification of the debtor*

(1) A notification of the assignment and a payment instruction are effective when received by the debtor, if they are in a language that is reasonably expected to inform the debtor about their contents. It shall be sufficient if a notification of the assignment or a payment instruction is in the language of the original contract.

(2) A notification of the assignment or a payment instruction may relate to receivables arising after notification.

(3) Notification of a subsequent assignment constitutes notification of any prior assignment.

Article 19. *Debtor's discharge by payment*

(1) Until the debtor receives notification of the assignment, the debtor is entitled to be discharged by paying in accordance with the original contract. After the debtor receives notification of the assignment, subject to paragraphs (2) to (6) of this article, the debtor is discharged only by paying the assignee or, if otherwise instructed in the notification of the assignment or subsequently by the assignee in a writing received by the debtor, in accordance with such instructions.

(2) If the debtor receives notification of more than one assignment of the same receivable made by the same assignor, the debtor is discharged by paying in accordance with the first notification received.

(3) If the debtor receives more than one payment instruction relating to a single assignment of the same receivable by the same assignor, the debtor is discharged by paying in accordance with the last payment instruction received from the assignee before payment.

(4) If the debtor receives notification of one or more subsequent assignments, the debtor is discharged by paying in accordance with the notification of the last of such subsequent assignments.

(5) If 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.

(6) 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 20. *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 any other contract that was part of the same transaction, 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.

(3) Notwithstanding paragraphs (1) and (2) of this article, defences and rights of set-off that the debtor may raise pursuant to article 11 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 21. *Agreement not to raise defences or rights of set-off*

(1) Without prejudice to the law governing the protection of the debtor in transactions made for personal, family or household purposes in the State in which the debtor is located, the debtor may agree with the assignor in a writing signed by the debtor not to raise against the assignee the defences and rights of set-off that it could raise pursuant to article 20. 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.

(3) Such an agreement may be modified only by an agreement in a writing signed by the debtor. The effect of such a modification as against the assignee is determined by article 22 (2).

Article 22. *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.

Article 23. *Recovery of payments*

Without prejudice to the law governing the protection of the debtor in transactions made for personal, family or household purposes in the State in which the debtor is located and the debtor's rights under article 20, failure of the assignor to perform the original contract does not entitle the debtor to recover from the assignee a sum paid by the debtor to the assignor or the assignee.

Section III. Other parties

Article 24. *Law applicable to competing rights of other parties*

With the exception of matters which are settled elsewhere in this Convention, and subject to articles 25 and 26, the law of the State in which the assignor is located governs:

(a) the extent of the right of an assignee in the assigned receivable and the priority of the right of the assignee with respect to competing rights in the assigned receivable of:

(i) another assignee of the same receivable from the same assignor, even if that receivable is not an international receivable and the assignment to that assignee is not an international assignment;

(ii) a creditor of the assignor; and

(iii) the insolvency administrator;

(b) the existence and extent of the right of the persons listed in paragraph (1) *(a)* (i) to (iii) in proceeds of the assigned receivable, and the priority of the right of the assignee in those proceeds with respect to competing rights of such persons; and

(c) whether, by operation of law, a creditor has a right in the assigned receivable as a result of its right in other property of the assignor, and the extent of any such right in the assigned receivable.

Article 25. *Public policy and preferential rights*

(1) The application of a provision of the law of the State in which the assignor is located may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.

(2) In an insolvency proceeding commenced in a State other than the State in which the assignor is located, any preferential right which arises under the law of the forum State and is given priority status over the rights of an assignee in insolvency proceedings under the law of that State has such priority notwithstanding article 24. A State may deposit at any time a declaration identifying those preferential rights.

Article 26. *Special proceeds rules*

(1) If proceeds of the assigned receivable are received by the assignee, the assignee is entitled to retain those proceeds to the extent that the assignee's right in the assigned receivable had priority over competing rights in the assigned receivable of the persons described in subparagraph *(a)* (i) to (iii) of article 24.

(2) If proceeds of the assigned receivable are received by the assignor, the right of the assignee in those proceeds has priority over competing rights in those proceeds of the persons described in subparagraph *(a)* (i) to (iii) of article 24 to the same extent as the assignee's right had priority over the right in the assigned receivable of those persons if:

(a) the assignor has received the proceeds under instructions from the assignee to hold the proceeds for the benefit of the assignee; and

(b) the proceeds are held by the assignor for the benefit of the assignee separately and are reasonably identifiable from the assets of the assignor, such as in the case of a separate deposit account containing only cash receipts from receivables assigned to the assignee.

Article 27. *Subordination*

An assignee entitled to priority may at any time subordinate unilaterally or by agreement its priority in favour of any existing or future assignees.

CHAPTER V. CONFLICT OF LAWS

Article 28. *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 rights and obligations of the assignor and the assignee under the contract of assignment are governed by the law expressly chosen by the assignor and the assignee.

(2) In the absence of a choice of law by the assignor and the assignee, their rights and obligations under the contract of assignment are 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 contract of assignment is presumed to be most closely connected with the State in which the assignor has its place of business. If the assignor has more than one place of business, reference is to be made to the place of business most closely connected to the contract. If the assignor does not have a place of business, reference is to be made to the habitual residence of the assignor.

(3) If the contract of assignment is connected with one State only, the fact that the assignor and the assignee have chosen the law of another State does not prejudice the application of the law of the State with which the assignment is connected to the extent that law cannot be derogated from by contract.

Article 29. *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 law governing the receivable to which the assignment relates determines the enforceability of contractual limitations on assignment, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and any question whether the debtor's obligations have been discharged.

[Article 30. *Law applicable to competing rights of other parties*

(1) The law of the State in which the assignor is located governs:

(a) the extent of the right of an assignee in the assigned receivable and the priority of the right of the assignee with respect to competing rights in the assigned receivable of:

(i) another assignee of the same receivable from the same assignor, even if that receivable is not an international receivable and the assignment to that assignee is not an international assignment;

(ii) a creditor of the assignor; and

(iii) the insolvency administrator;

(b) the existence and extent of the right of the persons listed in paragraph (1) *(a)* (i) to (iii) in proceeds of the assigned receivable, and the priority of the right of the assignee in those proceeds with respect to competing rights of such persons; and

(c) whether, by operation of law, a creditor has a right in the assigned receivable as a result of its right in other property of the assignor, and the extent of any such right in the assigned receivable.

(2) The application of a provision of the law of the State in which the assignor is located may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.

(3) In an insolvency proceeding commenced in a State other than the State in which the assignor is located, any preferential right which arises under the law of the forum State and is given priority status over the rights of an assignee in insolvency proceedings under the law of that State has such priority notwithstanding paragraph (1) of this article. A State may deposit at any time a declaration identifying those preferential rights.

Article 31. *Mandatory rules*

(1) Nothing in articles 28 and 29 restricts the application of the rules of the law of the forum State in a situation where they are mandatory irrespective of the law otherwise applicable.

(2) Nothing in articles 28 and 29 restricts the application of the mandatory rules of the law of another State with which the matters settled in those articles have a close connection if and in so far as, under the law of that other State, those rules must be applied irrespective of the law otherwise applicable.

Article 32. *Public policy*

With regard to matters settled in this chapter, the application of a provision of the law specified in this chapter may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.]

CHAPTER VI. FINAL PROVISIONS

Article 33. *Depositary*

The Secretary-General of the United Nations is the depositary of this Convention.

Article 34. *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 35. *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 any time, 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 36. *Conflicts with other international agreements*

This Convention does not prevail over any international agreement which has already been or may be entered into and which contains provisions concerning the matters governed by this Convention[, provided that the assignor is located in a State party to such agreement or, with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, the debtor is located in a State party to such agreement].

Article 37. *Application of chapter V*

A State may declare at any time that it will not be bound by chapter V.

Article 38. *Limitations relating to Governments and other public entities*

A State may declare at any time that it will not be bound by articles 11 and 12 if the debtor or any person granting a personal or property right securing payment of the assigned receivable is located in that State at the time of the conclusion of the original contract and is a Government, central or local, any subdivision thereof, or any public entity. If a State has made such a declaration, articles 11 and 12 do not affect the rights and obligations of that debtor or person.

[Article 39. *Other exclusions*

A State may declare at any time that it will not apply the Convention to specific practices listed in a declaration. In such a case, the Convention does not apply to such practices if the assignor is located in such a State or, with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, the debtor is located in such a State.]

Article 40. *Application of the annex*

(1) A Contracting State may at any time declare that [it will be bound either by sections I and/or II or by section III of the annex to this Convention.] [it:

(a) will be bound by the priority rules based on registration set out in section I of the annex and will participate in the international registration system established pursuant to section II of the annex;

(b) will be bound by the priority rules based on registration set out in section I of the annex and will effectuate such rules by use of a registration system that fulfils the purposes of such rules [as set forth in regulations promulgated pursuant to section II of the annex], in which case, for the purposes of section I of the annex, registration pursuant to such a system shall have the same effect as registration pursuant to section II of the annex; or

(c) will be bound by the priority rules based on the time of the contract of assignment set out in section III of the annex.

(2) For the purposes of article 24, the law of a Contracting State that has made a declaration pursuant to paragraph (1) *(a)* or (1) *(b)* of this article is the set of rules set forth in section I of the annex, and the law of a Contracting State that has made a declaration pursuant to paragraph (1) *(c)* of this article is the set of rules set forth in section III of the annex. The Contracting State may establish rules pursuant to which assignments made before the declaration takes effect shall, within a reasonable time, become subject to those rules.

(3) A Contracting State that has not made a declaration pursuant to paragraph (1) of this article may, pursuant to its domestic priority rules, utilize the registration system established pursuant to section II of the annex.]

Article 41. *Effect of declaration*

(1) Declarations made under articles 35 (1) and 37 to 40 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 35 (1) and 37 to 40 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.

[(5) A declaration or its withdrawal does not affect the rights of parties arising from assignments made before the date on which the declaration or its withdrawal takes effect.]

Article 42. *Reservations*

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

Article 43. *Entry into force*

(1) This Convention enters into force on the first day of the month following the expiration of six months 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 six months 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 article 1 (1).]

Article 44. *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.

[(3) The Convention remains applicable to assignments made before the date on which the denunciation takes effect.]

ANNEX TO THE DRAFT CONVENTION

Section I. Priority rules based on registration

Article 1. *Priority among several assignees*

As between assignees of the same receivable from the same assignor, priority is determined by the order in which data about the assignment are registered under section II of this annex, regardless of the time of transfer of the receivable. If no such data are registered, priority is determined on the basis of the time of the assignment.

Article 2. *Priority between the assignee and the insolvency administrator or the creditors of the assignor*

[Subject to article 25 of this Convention,] an assignee has priority over an insolvency administrator and creditors of the assignor, including creditors attaching the assigned receivables, if the receivables were assigned, and data about the assignment were registered under section II of this annex, before the commencement of the insolvency proceeding or attachment.

Section II. Registration

Article 3. *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 in detail the manner in which the registration system will operate, as well as the procedure for resolving disputes relating to that operation.

Article 4. *Registration*

(1) Any person authorized by the regulations may register data with regard to an assignment at the registry in accordance with this Convention and the registration regulations. The data registered shall be identification of the assignor and the assignee, as provided in the regulations, 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. The registering party may specify, from options provided in the regulations, a period of effectiveness for the registration. 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, and, consistent with this annex, such other matters as are necessary for the operation of the registration system.

(4) Any defect, irregularity, omission or error with regard to the identification of the assignor that would result in data registered not being found upon a search based on the identification of the assignor renders the registration ineffective.

Article 5. *Registry searches*

(1) Any person may search the records of the registry according to identification of the assignor, as provided in the regulations, 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.

Section III. Priority rules based on the time of the contract of assignment

Article 6. *Priority among several assignees*

As between assignees of the same receivable from the same assignor, the right to the receivable is acquired by the assignee whose contract of assignment is of the earliest date.

Article 7. *Priority between the assignee and the insolvency administrator or the creditors of the assignor*

[Subject to article 25 of this Convention,] an assignee has priority over an insolvency administrator and creditors of the assignor, including creditors attaching the assigned receivables, if the receivables were assigned before the commencement of the insolvency proceeding or attachment.

ANNEX II

RENUMBERING OF ARTICLES OF THE DRAFT CONVENTION*

Current article number (annex I to the present document)	*Former article number (A/CN.9/WG.II/WP.104)*
1	1
2	2
3	3
4	4
5	New article
6	5
7	6
8	7
9	8
10	9
11	10
12	11
13	13
14	14
15	15
16	16
17	17
18	18
19	19
20	20
21	21
22	22
23	23
24	24 (1), 25 (1) and (2) and 26 (3)and (4)
25	25 (3) and (5) and 26 (5)
26	26 (1) and (2)
27	24 (2)
28	27
29	28
30	29
31	30
32	31
33	32
34	38
35	39
36	33
37	34
38	12
39	35
40	36
41	40
42	41
43	42
44	43

*The articles of the annex were not renumbered.

B. Working paper submitted to the Working Group on International Contract Practices at its thirty-first session: draft Convention on Assignment in Receivables Financing: text with remarks and suggestions: note by the secretariat (A/CN.9/WG.II/WP.104) [Original: English]

CONTENTS

INTRODUCTION

1. At the present 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] This was the eighth session devoted to the preparation of this 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 (1980) had decided to defer for a later stage.

3. At its twenty-sixth to twenty-eighth sessions (1993 to 1995), the Commission discussed three reports prepared by

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

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 uncertaknty 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.[2]

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.[3]

6. At its twenty-fifth and twenty-sixth sessions (New York, 8-19 July and Vienna, 11-22 November 1996 respectively), the Working Group continued its work by considering different versions of the draft uniform rules contained in two notes prepared by the secretariat (A/CN.9/WG.II/WP.87 and A/CN.9/WG.II/WP.89 respectively). 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).

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] 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.[5]

8. At its twenty-seventh and twenty-eighth sessions (Vienna, 20-31 October 1997 and New York, 2-13 March 1998 respectively), the Working Group considered two notes prepared by the secretariat (A/CN.9/WG.II/WP.93 and A/CN.9/WG.II/WP.96 respectively). At its twenty-eighth session, the Working Group adopted the substance of draft articles 14 to 16 and 18 to 22 and requested the secretariat to revise draft article 17 (A/CN.9/447, paras. 161-164 and 68 respectively).

9. At its thirty-first session (1998), 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). The Commission expressed appreciation for the work accomplished and requested the Working Group to proceed with its work expeditiously so as to complete its work in 1999 and submit the draft Convention for adoption by the Commission at its thirty-third session (2000).[6]

10. At its twenty-ninth and thirtieth sessions (Vienna, 5-16 October 1998 and New York, 1-12 March 1999 respectively), the Working Group considered three notes prepared by the secretariat (A/CN.9/WG.II/WP.96, A/CN.9/WG.II/WP.98 and A/CN.9/WG.II/WP.102), as well as a note containing the report of a group of experts prepared by the Permanent Bureau of the Hague Conference on Private International Law (A/CN.9/WG.II/WP.99) and a proposal by the United States of America (A/CN.9/WG.II/WP.100). At those sessions, the Working Group adopted respectively the substance of the preamble and draft articles 1 (1) and (2), 5 *(g)* to *(j)*, 18 (5*bis*), 23 to 33 and 41 to 50 (A/CN.9/455, para. 17) and, with the exception of the bracketed language, the title, the preamble and draft articles 1 to 24 (A/CN.9/456, para. 18).

11. At its thirty-second session (1999), the Commission had before it the reports of the twenty-ninth and thirtieth sessions of the Working Group (A/CN.9/455 and A/CN.9/456). The Commission expressed appreciation for the work accomplished by the Working Group and requested the Working Group to proceed with its work expeditiously so as to make it possible for the draft Convention, along with the report of the next session of the Working Group, to be circulated to Governments for comments in good time and for the draft Convention to be considered by the Commission for adoption at its thirty-third session (2000). As regards the subsequent procedure for adopting the draft Convention, the Commission noted that it would have to decide at its next session whether it should recommend adoption by the General Assembly or by a diplomatic conference to be specially convened by the General Assembly for that purpose.[7]

12. In order to facilitate the considerations of the Working Group, this note reproduces the text adopted by the Working Group at its thirtieth session (A/CN.9/456, Annex), as well the private international law provisions and the final provisions adopted by the Working Group at its twenty-ninth session (A/CN.9/455, Annex, draft articles 29-33 and 41-50) and text not yet adopted by the Working Group (A/CN.9/WG.II/WP.96, draft articles 34-40; the underlined wording comes from A/CN.9/WG.II/WP.102). The note also sets forth remarks on a number of draft articles and, where necessary, suggestions for alternative or additional provisions for consideration by the Working Group.

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[2]*Official Records of the General Assembly, Forty-eighth Session, Supplement No. 17* (A/48/17), paras. 297-301; *Official Records of the General Assembly, Forty-ninth Session, Supplement No. 17* (A/49/17), paras. 208-214; and *Official Records of the General Assembly, Fiftieth Session, Supplement No. 17* (A/50/17), paras. 374-381.

[3]Ibid., *Fifty-first Session, Supplement No. 17* (A/51/17), para. 234.

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

[5]Ibid., para. 256.

[6]Ibid., *Fifty-third Session, Supplement No. 17* (A/53/17), para. 231.

[7]Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), para. 330.

[DRAFT CONVENTION ON ASSIGNMENT IN RECEIVABLES FINANCING]

[DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES [IN INTERNATIONAL TRADE]]

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 content and choice of legal regime applicable to assignments [of receivables] in international trade [constitute an obstacle to financing transactions],

Desiring to establish principles and adopt rules [relating to the assignment of receivables] that would create certainty and transparency and promote modernization of law relating to [assignments of receivables] [receivables financing] [including but not limited to assignments used in factoring, forfaiting, securitization, project financing, and refinancing,] while protecting existing [financing] [assignment] practices and facilitating the development of new practices,

Also desiring to ensure the adequate protection of the interests of the debtor in the case of an assignment of receivables,

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

Have agreed as follows:

Remarks

1. At its previous session, the Working Group noted that the title and the preamble of the draft Convention appeared to be inconsistent with the scope provisions, according to which the draft Convention could apply to assignments outside a strictly financing context (A/CN.9/456, para. 60). In an attempt to align the title and the preamble with the scope provisions and to avoid raising questions of interpretation as to the exact scope of the draft Convention, the deletion from the title and the preamble of any reference to financing was proposed (A/CN.9/456, para. 61).

2. At the same session, the Working Group noted that the approach taken by the Working Group at previous sessions that, while the main focus of the draft Convention would be on financing transactions, other related transactions should not be excluded, was consistent with the mandate given by the Commission to the Working Group (A/CN.9/456, para. 63). At its thirty-second session, in response to a question raised, the Commission reaffirmed the flexible mandate given to the Working Group to determine how broad or narrow the scope of application of the draft Convention should be.[8]

3. It will be recalled that the Working Group decided not to limit the scope of the draft Convention to transactions with a "financing" or "commercial" nature or context, since such a limitation: would inappropriately create yet another special regime on assignment, where one was in principle not justified, and thus inadvertently result in further disunification of the law on assignment; would raise uncertainty since the terms "financing" and "commercial" were not universally understood in the same way, nor was it feasible or desirable to attempt to define them in a uniform way in an international convention; and would unnecessarily exclude from the scope of the draft Convention important transactions such as, e.g. assignments in international factoring transactions in which insurance against debtor-default or book-keeping and collection services are provided. The Working Group rather preferred to start from a broad scope of application and to exclude transactions that were of a consumer nature or were already well regulated (A/CN.9/420, paras. 41-43; A/CN.9/432, paras. 14-18 and 66; A/CN.9/434, paras. 18 and 42-61).

4. Should the Working Group confirm its decision not to limit the scope of application of the draft Convention to assignments made for "financing" purposes, it might wish to delete the reference to "receivables financing" from the title and the preamble of the draft Convention and to include an explanation of the matter in the commentary to the draft Convention. Alternatively, a reference to receivables financing could be retained in the preamble, but not in the title, of the draft Convention, and explained in the commentary (see also remark 1 to draft article 5). Such a reference in the preamble could operate as a guidance with regard to the main objectives of the draft Convention, without limiting the scope of the draft Convention, a matter that could be usefully clarified in the commentary.

5. If the Working Group follows this approach, it may wish to consider the question whether the reference to international trade in the title of the draft Convention, which appears within square brackets, should be retained. The retention of a reference to international trade in the title presents a number of advantages, including that: it sufficiently reflects the overall objective of the draft Convention to facilitate the movement of goods and services across borders; and appropriately clarifies that the draft Convention applies to assignments with an international and commercial element, without attempting to regulate consumer assignments or domestic assignments of domestic receivables.

6. On the other hand, such a reference to international trade may inadvertently give the impression that the draft Convention applies only to assignments of receivables generated in international trade and not to: the assignment of consumer receivables; the international assignment of domestic receivables; or the assignment of receivables arising from loan or other transactions that may not involve the sale of goods or the provision of services. In addition, such a reference might fail to reflect the fact that the draft Convention might affect domestic assignments of domestic receivables in that it is intended to provide which law applies to a conflict between a domestic and a foreign assignee of domestic receivables (see remarks 3-5 to draft article 1). On balance, however, it would seem that, in line with practice followed in other UNCITRAL texts, a reference to

[8]Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17, para. 326).

international trade (or commerce) would be appropriate. As to the problems identified above, the Working Group may wish to address them in the commentary to the draft Convention, explaining that the term "international trade" is used in a broad sense and is intended to cover all the activities defined as "commercial" in the footnote to article 1 (1) of the UNCITRAL Model Law on International Commercial Arbitration.

CHAPTER I. SCOPE OF APPLICATION

Article 1. *Scope of application*

(1) This Convention applies to:

(a) assignments of international receivables and to international assignments of receivables as defined in this chapter, if, at the time of the conclusion of the contract of assignment, the assignor is located in a Contracting State;

(b) subsequent assignments provided that any prior assignment is governed by this Convention; and

(c) subsequent assignments that are governed by this Convention under subparagraph *(a)* of this paragraph, notwithstanding that any prior assignment is not governed by this Convention.

(2) This Convention does not affect the rights and obligations of the debtor unless the debtor is located in a Contracting State or the law governing the receivable is the law of a Contracting State.

[(3) The provisions of chapter V 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] [independently of the provisions of this chapter]. However, those provisions do not apply if a State makes a declaration under article 34.]

(4) The annex to this Convention applies in a Contracting State which has made a declaration under article 36.

Remarks

1. Paragraph (3) appears within square brackets since it has not been adopted by the Working Group yet (A/CN.9/456, para. 26). The wording proposed by the secretariat in a previous paper (A/CN.9/WG.II/WP.102, remark 23 to draft article 1) has been slightly modified to allow States to opt out of chapter V as a whole, including draft articles 30 and 31 dealing with reservations as to the application of mandatory law and public policy. The secretariat had originally suggested that those provisions could be excluded from an opt-out, in order for them to apply to private law provisions outside chapter V (A/CN.9/WG.II/WP.102, remark 20 to draft article 1).

2. The modification is intended to avoid inadvertently subjecting the application of the substantive law provisions of the draft Convention to mandatory law or public policy, which could make it impossible to predict whether the draft Convention would apply or be set aside by a judge on the basis of not widely known or possibly surprising notions of mandatory law or public policy. However, the issue whether the law applicable by virtue of the private international law provisions of the draft Convention may be set aside if it is manifestly contrary to super-mandatory law (*loi de police*) and public policy remains to be resolved (see remarks to draft article 24).

3. So far, the Working Group has worked on the assumption that draft article 24 will apply to a conflict between a domestic and a foreign assignee of domestic receivables. One of the reasons for which the Working Group decided to turn the priority rules of the draft Convention into private international law rules was that such rules would not negatively affect the rights of domestic assignees of domestic receivables, since issues of priority would be left to substantive law applicable outside the draft Convention (A/CN.9/445, para. 22).

4. Should the Working Group confirm its assumption that conflicts of priority between a domestic and a foreign assignee of domestic receivables would be covered in draft article 24, the domestic assignee would have to meet the requirements of the same law it would probably expect to be applied anyway (since, by definition, in a domestic assignment of domestic receivables, the law of the assignor's, the assignee's and the debtor's jurisdiction would be the same, while in an international assignment only the assignee would be in a different State). If the Working Group defines "location" of the assignor for the purposes of the priority rules by reference to its central administration (but not for the purpose of the scope rules; see remark 4 to draft article 5), a different law might apply to a conflict between an assignment by a branch of an entity in the debtor's jurisdiction and a second assignment by the head office of the same entity in another jurisdiction (if one of those two States is not a Contracting State). However, even in such a case the domestic assignee could predict that the draft Convention could apply, since the domestic assignee: would be located in a Contracting State (i.e. the same State in which the assignor and the debtor would have their places of business); and would know that the assignor is a branch of a foreign entity. On the other hand, if draft article 24 did not apply to such a conflict, the foreign assignee may have no way to determine that a law other than the law of the assignor's central administration might apply. Depending on the frequency of such assignments by head and branch offices, the problem may be left to other law. In its consideration of this matter, the Working Group may also wish to take into account the need to avoid inadvertently interfering with domestic practices, a result which could reduce the acceptability of the draft Convention.

5. The Working Group may wish to consider for inclusion in draft article 1 or in draft article 24 wording along the following lines: "Article 24 of this Convention applies to a conflict of priority between an assignee in a domestic assignment of domestic receivables and an assignee in an international assignment of the same domestic receivables from the same assignor."

Article 2. *Assignment of receivables*

For the purposes of this Convention:

(a) "Assignment" means the transfer by agreement from one person ("assignor") to another person ("as-

signee") of the assignor's contractual right to payment of a monetary sum ("receivable") from a third person ("the debtor"). The creation of rights in receivables as security for indebtedness or other obligation is deemed to be a transfer;

(b) In the case of an assignment by the initial or any other assignee ("subsequent assignment"), the person who makes that assignment is the assignor and the person to whom that assignment is made is the assignee.

Remarks

1. The reference to "contractual" receivables is intended to ensure that the draft Convention applies, for example, to the assignment of receivables arising under contracts for the sale of goods or the provision of services, whether those contracts are commercial or consumer transactions, as well as to the assignment of receivables in the form of royalties arising from the licensing of intellectual property and of receivables in the form of credit balances in deposit accounts or securities transactions. The assignment of tort and tax receivables or receivables determined in court judgements is not covered, unless those receivables are confirmed in a settlement agreement.

2. The Working Group may wish to consider whether the assignment of receivables under the draft Convention would include: damages for breach of contract (liquidated or not); interest for late payment (contractual interest, statutory interest or interest liquidated in a court judgement); sums payable as dividends (present or future) arising from shares; and receivables based on arbitral awards.

3. Under subparagraph *(a)*, what constitutes a "contractual" right is left to law applicable outside the draft Convention. In view of the divergences existing between legal systems in this context, such an approach may, in some cases in which it may not be easy to distinguish between a contractual and an extra-contractual relationship, create uncertainty. In order to avoid this result, the Working Group may wish to consider defining the term "contractual" right in a negative way (e.g. "a right to payment of a monetary sum other than one arising by operation of law or determined in a court judgement"). Alternatively, the matter could be explained in the commentary.

Article 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 of the conclusion of the contract of assignment, the assignor and the assignee are located in different States.

Remarks

Under draft article 3, once a receivable is international, its assignment is always covered by the draft Convention (whether it is domestic or international). However, once a receivable is domestic, its assignment may be covered by the draft Convention, if: it is international; or it is domestic but is also part of a chain of assignments which includes an international assignment (for an additional situation in which a domestic assignment of domestic receivables may be affected, see remarks 3-5 to draft article 1). In order to limit the references in the text to the time when a receivable arises (term defined in draft article 5 *(b)*) and to align the wording of the first sentence with that of the second sentence, the words "at the time of the conclusion of the original contract" may be substituted for the words "at the time it arises" (see remark 1 to draft article 5).

Article 4. *Exclusions*

[(1)] This Convention does not apply to assignments:

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

(b) to the extent made by the delivery of a negotiable instrument, with any necessary endorsement;

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

[(2) This Convention does not apply to assignments listed in a declaration made under draft article 35 by the State in which the assignor is located, or with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, by the State in which the debtor is located.]

Remarks

1. In view of the broad scope of application of the draft Convention, the Working Group decided to list assignments that should not be covered. In particular, the exclusion of assignments for consumer purposes is intended to emphasize that only assignments for commercial purposes are to be covered (without referring to the commercial purposes in order to avoid creating uncertainty). However, it would seem that assignments made from an individual to a financing institution, i.e. for mixed, consumer and commercial purposes, should not be excluded. In addition, subparagraph *(a)* may need to be revised in order to avoid inadvertently giving the impression that it is intended to exclude the assignment of consumer receivables. Thus, the Working Group may wish to reformulate subparagraph *(a)* along the following lines "made from one individual to another for personal, family or household purposes common to both" (in draft articles 21 (1) and 23, the use of the term "primarily" for personal, family or household purposes is made, but in that context the term "purposes" relates to one party, the debtor). The commentary will explain that only assignments from one consumer to another consumer are excluded and that in all other cases the assignment of consumer receivables is covered. The Working Group may wish to consider that such consumer assignments are extremely rare in practice and that, in the absence of an explanation in the commentary, such an exclusion may be inadvertently misunderstood as relating to the assignment of consumer receivables. In such a case, subparagraph *(a)* may be deleted altogether, while the commentary could explain that assignments from one consumer to another are not covered.

2. As to assignments of receivables in the context of a sale of a business as a going concern, the commentary may explain that, while the assignment from the seller to the

buyer of the business is excluded, the assignment to an institution financing the sale is not excluded (A/CN.9/432, para. 66; and A/CN.9/434, paras. 42-61).

3. At the previous session of the Working Group, additional assignments were identified for possible exclusion, i.e. assignments of receivables arising in clearing-house, swaps and derivatives transactions and assignments of receivables arising from the sale or lease of high-value, highly mobile equipment (A/CN.9/456, paras. 48 and 49 and 232-239).

4. As to clearing-house, swaps and derivatives transactions, in order to avoid unsettling existing and well-functioning practices, the Working Group may wish to consider whether they should be excluded altogether or be dealt with differently. While it is a matter of discussion whether all of those transactions would create receivables the assignment of which would be covered by the draft Convention, it appears that the main concern in such transactions is that an assignment made without the consent of the debtor may inappropriately oblige the debtor to pay a third party, freeze the debtor's defences and rights of set-off and introduce an inappropriate priority regime.

5. Before deciding in favour of a blank exclusion of all those practices which may deprive parties thereto of the benefits to be derived from the draft Convention, the Working Group may wish to consider whether it can possibly address the relevant concerns in another way. For example, the Working Group may wish to include in the draft Convention a rule under which the debtor in such transactions (and possibly in insurance policies, which establish a strictly personal relationship between the insurer and the insured, and in loan syndications and participations, which normally involve the assignment of single, large-value receivables) will not be bound or affected in any way by an assignment. Such a rule would not prevent assignments, except that the assignee would not be able to collect from the debtor. The assignee would have priority over other claimants, but, as long as the debtor is not bound against its will and does not lose its defences and rights of set-off, the priority regime of the draft Convention would not affect the debtor. This result may be achieved by a general principle along the following lines: "Nothing in this Convention affects the rights and obligations of an intermediary in clearing house, swaps and derivatives transactions [, insurance policies and loan syndications and participations] without the intermediary's [, the insurer's or any lender's] consent." The same result may also be achieved by inserting in draft article 10 language along the following lines: "An assignment of receivables arising under clearing-house, swaps or derivatives transactions [, insurance policies or loan syndications and participations] is ineffective as against the debtor unless it is consented to by the debtor, whether or not there is a contractual limitation to such an assignment." Alternatively, the two provisions proposed above may be combined in one new provision.

6. In addition, the Working Group may wish to consider modifying draft article 20 to ensure that, in clearing-house, swaps and derivatives transactions, insurance policies and loan syndications and participations, notification does not freeze the defences and rights of set-off of the debtor, whether they arise from the original or any other contract. Such a modification of draft article 20 may not be necessary, since parties would have an opportunity to consider whether they wish to continue the transaction in view of the fact that the debtor would not be able to raise certain defences and rights of set-off arising after notification of an assignment. However, the application of draft article 20 may be problematic, since in some of those transactions it may not always be clear which is the original contract and which party is creditor or debtor, since any party may be debtor or creditor depending on the time one examines the transaction. Moreover, the Working Group may wish to consider a different priority regime from that embodied in draft articles 25 to 26, at least with regard to some of those practices. For example, in transactions involving investment property or deposit accounts, priority may need to be left to the law of the location of the securities intermediary or of the depositary institution, rather than to the law of the assignor's location.

7. If there is no agreement on the above-mentioned approach or if it is considered that it does not sufficiently address the relevant concerns, the Working Group may wish to consider excluding those practices altogether in draft article 4 (1) or leaving the matter to each State to settle by way of a declaration under draft articles 4 (2) and 35. The advantage of a draft article 4 (1) exclusion would lie in the certainty that may be achieved by a uniform rule applicable to all Contracting States. The disadvantage of such an approach would be that certain practices may have to be excluded for all Contracting States, even though their coverage in the draft Convention would raise concerns only in one or more Contracting States. Another possible disadvantage of such an approach is that it would not allow a State the flexibility to exclude practices if a concern with covering those practices in the draft Convention arises in the future. On the other hand, allowing each State to exclude practices by way of a declaration under draft articles 4 (2) and 35 may introduce an undesirable degree of uncertainty. If such an approach were to be followed, the scope of application of the draft Convention may differ from State to State and from time to time. As a result, parties to the relevant transactions may have to determine in each case the scope of application of the draft Convention.

8. As to transactions relating to mobile equipment, in order to avoid any conflicts with the draft convention and the equipment-specific protocols being prepared by the International Institute for the Unification of Private Law (Unidroit) in cooperation with the International Civil Aviation Organization (ICAO) and other organizations (hereinafter referred to as "the Unidroit draft Convention"), the Working Group may wish to consider whether the assignment of receivables arising from the sale or lease of and secured by mobile equipment should be excluded altogether (in the draft Convention or in the Unidroit draft Convention or relevant protocol) or be dealt with by way of a provision settling any conflicts that might arise between those texts (either in a uniform way for all Contracting States or by leaving it to each State to decide to which text it wishes to give precedence). Such conflicts may arise, since the Unidroit draft Convention, for example: requires consent of the debtor for an assignment to be effective;

subjects priority with respect to mobile equipment and receivables inextricably linked thereto to an equipment-specific system of international registration; and vests the equipment financier with wide self-help powers, in particular in the case of insolvency in which the financier has the power to repossess the equipment after the opening of the insolvency proceeding if the insolvent debtor does not cure the default within a certain period of time.

9. If it is agreed that the regime introduced by the draft Convention is not appropriate for the assignment of receivables arising, for example, from the sale or lease of aircraft, as it is practised under current law, and that the particular needs of the relevant practices cannot be addressed by introducing additional rules in the draft Convention, the Working Group may wish to consider excluding in draft article 4 (1) the assignment of receivables secured by such equipment (it should be noted though that, while a parallel may be drawn, in some legal systems, between high-value equipment and real estate, the assignment of receivables arising from the sale or lease of real estate cannot be excluded, since receivables secured with a mortgage in real estate are often part of securitization schemes). Certainty in the application of the draft Convention and avoidance of any undue interference with well-regulated practices would be the main advantages of such an approach. For the same reasons, article 2 of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980; hereinafter referred to as the "Sales Convention") excludes the sale of certain types of goods (e.g. electricity, negotiable instruments, ships and aircraft).

10. As to the question of which types of practices should be excluded, the Working Group may wish to take into account, for example, that receivables arising from the sale or lease of and secured by aircraft are normally part of equipment, rather than receivables, financing transactions, at least to the extent that they are secured by the aircraft and the security interest is registered in the aircraft registry. In such situations, potential financiers of receivables secured by aircraft would know that they should have to look to the aircraft registry to determine their priority position and to decide on that basis whether to provide credit and at what cost. It should be noted, however, that receivables arising from ticket sales are normally part of securitization schemes, rather than equipment financing, and thus their assignments should not be excluded from the scope of the draft Convention.

11. While it may be appropriate to follow the same approach with regard to satellites, it remains to be established that it should be followed with regard to other types of space equipment (e.g. control panels located on earth), railway rolling stock, oil rigs, containers or similar types of equipment. Caution would need to be exercised, since this approach could inadvertently result in limiting excessively the scope of the draft Convention, if mobile equipment were defined in the Unidroit draft Convention, as is presently the case (art. 3), as including "any uniquely identifiable object", i.e. cars, trucks, computers, television sets and the like.

12. Should the Working Group decide to follow this approach, a new subparagraph *(d)* may be inserted in draft article 4 (1) along the following lines: "made as part of transactions relating to security interests, conditional sales under reservations of title or leasing agreements with respect to [aircraft] and receivables arising from the sale or lease secured by [or associated with] such equipment." The term "aircraft" is within square brackets pending determination by the Working Group of the exact formulation of the exception and of other practices in which receivables may be part of equipment, rather than receivables, financing. The words "or associated with", which come from the definition of "associated rights" contained in draft article 1 of the Unidroit draft Convention, are within square brackets since they appear to be vague and may inadvertently broaden excessively the scope of the exclusion.

13. If, on the other hand, the problem with covering such practices in the draft Convention does not lie in the risk that the draft Convention may unsettle current practices but in the risk of creating conflicts with a future text, such as the Unidroit draft Convention, or of unsettling practices that may develop in the future, it may be preferable to address this problem by way of a provision settling any conflicts between the two texts, preferably in a uniform way for all States. Such an approach would present certain advantages, including that: it would settle the matter of potential conflicts with an acceptable degree of certainty; and it would avoid leaving a gap in case one or the other text is not widely adopted in a timely fashion (the Unidroit draft Convention will enter into force in stages as soon as an equipment-specific protocol enters into force and an equipment-specific registration system is in place). The question as to which text should have precedence may need to be answered differently depending on the type of equipment involved. For example, precedence may be given to the aircraft protocol but not to any other protocol.

14. Should the Working Group decide to follow this approach, language along the following lines may be inserted in draft article 33 as a new paragraph (2): "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 security interests, conditional sales under reservations of title and leasing agreements with respect to [aircraft] and receivables arising from the sale or lease secured by [or associated with] such equipment."

15. Alternatively, the extent to which any other text dealing with similar matters may prevail over the draft Convention may be left to that other text. Under such an approach, in the preparation of each protocol, it would have to be determined whether receivables secured by the relevant type of equipment are part of equipment, rather than receivables, financing. The matter of the assignment of rights secured by mobile equipment, which is currently addressed in the base draft Unidroit Convention, would need to be left to each protocol to that draft Convention. In addition, the notion of "equipment" would have to be limited to certain high-value types of equipment and could not relate to "any uniquely identifiable object" since such a broad approach could inadvertently encompass consumer goods, such as cars and personal computers, and interfere with receivables financing practices, such as the securitization of consumer receivables. As a matter of drafting, if the Working Group agrees to insert a new provision in draft article 33, a refer-

ence to paragraphs (2) and (3) would need to be added in paragraph (1) of draft article 33 and the current paragraph (2) would need to be renumbered.

16. Paragraph (2) and draft article 35 foresee an additional way in dealing with the exclusion of practices, leaving the matter to each State. However, allowing each State to, in essence, define the scope of application of the draft Convention by excluding (or including) practices at any time would introduce an undesirable degree of uncertainty. If such an approach were to be followed, in view of the multiplicity of parties involved in assignment-related transactions, it may be very difficult to determine in each case which law applies. Thus, the Working Group may wish to consider deleting paragraph (2) and draft article 35.

CHAPTER II. GENERAL PROVISIONS

Article 5. *Definitions and rules of interpretation*

For the purposes of this Convention:

(a) "original contract" means the contract between the assignor and the debtor from which the assigned receivable arises;

(b) a receivable is deemed to arise at the time when the original contract is concluded;

(c) "existing receivable" means a receivable that arises upon or before the conclusion of the contract of assignment; "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 information that is accessible so as to be usable for subsequent reference. Where this Convention requires a writing to be signed, that requirement is met if, by generally accepted means or a procedure agreed to by the person whose signature is required, the writing identifies that person and indicates that person's approval of the information contained in the writing;

(f) "notification of the assignment" means a communication in writing which reasonably identifies the assigned receivables and the assignee;

(g) "insolvency administrator" means a person or body, including one appointed on an interim basis, authorized in an insolvency proceeding to administer the reorganization or liquidation of the assignor's assets or affairs;

(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 or other competent authority for the purpose of reorganization or liquidation;

(i) "priority" means the right of a party in preference to another party;

[*(j)* [For the purposes of articles 24 and 25,] an individual is located in the State in which it has its habitual residence; a corporation is located in the State in which it is incorporated; a legal person other than a corporation is located in the State in which its constitutive document is filed and, in the absence of a filed document, in the State in which it has its chief executive office.]

[*(k)* [For the purposes of articles 1 and 3:]

(i) the assignor is located in the State in which it has that place of business which has the closest relationship to the assignment;

(ii) the assignee is located in the State in which it has that place of business which has the closest relationship to the assignment;

(iii) the debtor is located in the State in which it has that place of business which has the closest relationship to the original contract;

(iv) in the absence of proof to the contrary, the place of central administration of a party is presumed to be the place of business which has the closest relationship to the relevant contract. If a party does not have a place of business, reference is to be made to its habitual residence[;

(v) several assignors or assignees are located at the place in which their authorized agent or trustee is located]].

Remarks

1. The Working Group may wish to consider whether subparagraph *(b)* is necessary. Currently, reference to the time at which a receivable arises is made in draft articles 3 and 8 (2) (in both provisions, a direct reference to the time of the conclusion of the original contract may be made). A reference to the fact of a receivable "arising" (without a reference to time) is made in draft articles 5 *(a)* and *(c)* and 12.

2. The Working Group may also wish to delete subparagraph *(d)* and to include a description of the practices to be covered by the draft Convention in the commentary (the reference to receivables financing could be retained in the preamble, if necessary; see remarks to the title and the preamble).

3. The Working Group may wish to insert at the end of the definition of "priority"in draft article 5 *(i)* wording along the following lines: "and includes the issue whether that party has a right in rem or ad personam" (see remark 1 to draft article 26).

4. Subparagraphs *(j)* and *(k)* reflect the divergence of views in the Working Group as to the issue of location of a legal person. The reference to draft articles 1, 3, 24 and 25 appears in square brackets, since the Working Group has not reached agreement on the question whether a different location rule should be adopted for the purpose of some of the provisions of the draft Convention in which the term "location" appears (i.e. draft articles 1, 3, 21 (1), 23-26, 27-29 and 39 (3)). However, at the previous session of the Working Group, there appeared to be agreement, at least: that the need for certainty was much stronger in the

priority provisions than in the scope provisions; that the scope of application of the draft Convention should be as broad as possible; that, in order to achieve a sufficient degree of debtor-protection, at least, with regard to the debtor's location, reference should be made to the relevant place of business; and that a solution with regard to the priority provisions could be built around the concept of central administration/chief executive office of an entity (A/CN.9/456, paras. 35-37). In view of the above, the Working Group may wish to consider a provision along the following lines:

"(i) a party is located in the State in which it has its place of business;

"(ii) if the assignor or the assignee have more than one place of business, the place of business is that which has the closest relationship to the contract of assignment. If the debtor has more than one place of business, the place of business is that which has the closest relationship to the original contract. If a party does not have a place of business, reference is to be made to the habitual residence of that party;

"(iii) for the purposes of articles 24 to 26, the place where the central administration of an entity is exercised de facto is deemed to be the place of business with the closest relationship to the contract of assignment[;

"(iv) several assignors or assignees are located at the place in which their authorized agent or trustee is located]."

5. The main difference between the proposed text and the current formulation of subparagraph *(k)* is that, with regard to the priority provisions of the draft Convention, the proposed text does not create a presumption that would almost certainly be rebutted in the case of branch offices, but a legal fiction that could not be rebutted. Such an approach would have the advantage of maintaining a balance between flexibility and certainty with regard to the application of the draft Convention, while giving precedence to certainty with regard to the priority provisions of the draft Convention.

6. Under such an approach, in the case of subsequent assignments under draft article 1 *(b)*, reference would be made to the place with which any prior assignment is most closely connected, and in the case of subsequent assignments under draft article 1 *(c)*, reference would be made to the place with which a subsequent assignment is most closely connected (similarly, internationality would have to be determined by reference to the place with the closest connection with the subsequent assignment).

7. As a matter of drafting, the Working Group may wish to avoid referring to "location" in draft articles 24 to 26 and to refer directly to the law of the State in which the assignor has its central administration. The need to subject priority issues in the case of an insolvency or other proceeding to the law of the assignor's main jurisdiction should be sufficient to justify referring to the place of the assignor's central administration as a connecting factor for the determination of the law governing such priority issues. As to conflicts among several assignees of the same receivables, while a place-of-business approach would be appropriate in the case of an assignor with a single place of business, it would be entirely unworkable if the assignor has more than one place of business (if, e.g. the same receivables are assigned by the head office and by a branch office, or by different branch offices, or by partners in a limited partnership located in different States, not all of which have adopted the draft Convention). In such a case, the application of a place-of-business approach could result in priority issues being governed by different laws and an assignee would have no way to know the circumstances under which the assignor assigned the same receivables several times.

8. A possible disadvantage of a bifurcated approach to the issue of location is that, if the place of business and the place of central administration do not coincide, assignees would have to check two different laws, the law of the place of business of the assignor for determining whether the draft Convention would apply and the law of the place of central administration of the assignor for determining the risk involved in the case of a double assignment or insolvency of the assignor (for another possible disadvantage, see remark 4 to draft article 1). However, this may be unavoidable, since a uniform approach appropriate in all circumstances does not seem to exist (as confirmed by the discussions in the Working Group and the UNCITRAL/Hague Conference group of experts; for the views of the latter group, see A/CN.9/WG.II/WP.99, part 3, definition of the concept of "location").

9. Compared with the place of incorporation, the place of central administration presents the advantage that it is a notion known in most legal systems and its application would not raise the possible problem of the application of an artificial jurisdiction without any developed laws as could be the case if reference were to be made to the place of incorporation. However, the place of central administration may not be as transparent as the place of incorporation, in particular: where the place of exercise of central authority is so evenly divided between two or more countries as to make the choice of one over the other impossible; and in the case of subsidiary companies where the real administrative control resides in the parent company. While revising new subparagraph *(j)* (iii) to create a rebuttable presumption ("in the absence of proof to the contrary") could provide a solution to this problem, it would seem that such an approach would not be appropriate, since it would inadvertently result in reducing the level of certainty achieved by this rule. In an effort to address this problem, the Working Group may wish to refer in new subparagraph *(j)* (iii) first to the place designated in the constitutive documents of an entity and, only in the absence of such a designation, to the de facto place of central administration (article 21 of the Swiss Private International Law Code).

10. As to the question whether the centre of main interests should be preferred for reasons of consistency with the European Union Convention on Insolvency Proceedings (hereinafter referred to as "the EU Insolvency Convention") and the UNCITRAL Model Law on Cross-Border Insolvency, it may be noted that the centre of main interests is akin to central administration, chief executive office or principal place of business. All those terms are understood as denoting the centre of management and control, the real

business centre from which the important activities of an entity are controlled, rather than the day-to-day management of the affairs and operations of such an entity. However, the rebuttable presumption established in those texts that the centre of main interests is the place of registration or, in the case of individuals, of the habitual residence of a party, may reduce the level of certainty necessary in a text, whose main focus is on the advance planning in the financing of a solvent debtor (A/CN.9/455, para. 27).

Article 6. *Party autonomy*

The assignor, the assignee and the debtor may derogate from or vary by agreement provisions of this Convention relating to their respective rights and obligations. Such an agreement does not affect the rights of any person who is not a party to the agreement.

Article 7. *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.

CHAPTER III. EFFECTS OF ASSIGNMENT

Remarks

1. The provisions in chapter III deal with the substantive validity (more accurately, effectiveness erga omnes) of an assignment. They do not deal, however, with formal validity. After the deletion of the provision dealing with form (A/CN.9/WG.II/WP.102, draft article 9), formal validity is left to the law applicable outside the draft Convention (A/CN.9/456, para. 91). This law would presumably be the law of the contract of assignment (which could be the law of the assignor's or the assignee's place of business or, if the assignor or the assignee have more than one place of business, the place of business with the closest connection to the contract) or the law of the place in which the contract was concluded (which could be a place other than the place of business of the assignor or the assignee). As a result, in view of the fact that priority presupposes both substantive and formal validity, an assignee would have to ensure that it has a valid assignment under the provisions of chapter III and under the law governing formal validity, as well as priority under the law of the assignor's location. This result could reduce certainty and thus have a negative impact on the cost of credit.

2. In order to address this problem, the term "priority" could be defined as including formal validity so that priority and formal validity are made subject to the same law. Alternatively, a rule may be included, preferably, at the beginning of chapter III or, alternatively, in chapter V along the following lines: "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." (A/CN.9/WG.II/WP.96, draft article 9, variant C).

3. In line with the approach of the Working Group to focus on the assignment, rather than on the contract of assignment, the above-mentioned provision makes reference to the assignment. Formal validity is subjected to the law of the assignor's location, in order to ensure: that the law of single jurisdiction would govern; and that law would be the same as the law governing priority (in order to achieve this result, the meaning of "location" in this context would have to be the same as in draft articles 24 to 26).

Article 8. *Effectiveness of bulk assignments, assignments of future receivables, and partial assignments*

(1) An assignment of existing or future, one or more, receivables, and parts of, or undivided interests in, receivables is effective, whether the receivables are described:

(a) individually as receivables to which the assignment relates; or

(b) in any other manner, provided that they can, at the time when the receivables arise, be identified as receivables to which the assignment relates.

(2) Unless otherwise agreed, an assignment of one or more future receivables is effective without a new act of transfer being required to assign each receivable when it arises.

Article 9. *Time of assignment*

An existing receivable is transferred, and a future receivable is deemed to be transferred, at the time of the conclusion of the contract of assignment, unless the assignor and the assignee have specified a later time.

Article 10. *Contractual limitations on assignments*

(1) An assignment of a receivable is effective notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee, 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 for breach of such an agreement. A person who is not party to such an agreement is not liable under that agreement for its breach.

Remarks

1. As already mentioned (see remark 5 to draft article 4), if practices, such as those involving clearing-house, swaps and derivatives transactions, insurance policies or loan syndications and participations, are to be covered by the draft Convention, a different rule may need to be included in draft article 10 with regard to those practices. Such a rule could provide that, in the absence of a consent by the debtor in those transactions, an assignment is not effective

as against the debtor (for potential additional changes in the draft Convention to address the particular needs of those practices, see remark 6 to draft article 4).

2. The second sentence of paragraph (2), stating that the assignee has no contractual liability for breach of an anti-assignment clause by the assignor, appears to be stating the obvious (the assignee cannot have contractual liability for breach of a contract to which the assignee is not a party). The original intention of the Working Group was that, while, obviously, the assignee would have no contractual liability, the issue of tort liability would be left to law applicable outside the draft Convention (A/CN.9/455, para. 51). The Working Group envisaged situations in which the assignee engages in manifestly improper behaviour (for example, induces the assignor to assign receivables in violation of an anti-assignment clause with the intent to harm the interests of the debtor). However, mere knowledge by the assignee of the existence of an anti-assignment clause should not give rise to liability of the assignee, since such a possibility might deter potential assignees from entering into receivables financing transactions (A/CN.9/455, para. 50).

3. While the matter can be explained in the commentary, the Working Group may wish to settle it explicitly by deleting the words "under that agreement for its breach"and inserting instead language along the following lines: "even if it had knowledge of such an agreement" or "on the sole ground that it had knowledge of such an agreement" or "unless that person acts with the specific intent to cause loss or recklessly *and* with actual knowledge that the loss would be likely to result" (in any of those cases, mere knowledge would not be sufficient to establish liability; see article 18 of the UNCITRAL Model Law on International Credit Transfers and article 8 of the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules)).

Article 11. *Transfer of security rights*

(1) A personal or property right securing payment of the assigned receivable is transferred to the assignee without a new act of transfer, unless, under the law governing the right, it is transferable only with a new act of transfer. If such a right, under the law governing it, is transferable only with a new act of transfer, the assignor is obliged to transfer this right and any proceeds to the assignee.

(2) A right securing payment of the assigned receivable is transferred under paragraph (1) notwithstanding an agreement between the assignor and the debtor or other person granting the right, limiting in any way the assignor's right to assign the receivable or the right securing payment of the assigned receivable.

(3) Nothing in this article affects any obligation or liability of the assignor for breach of an agreement under paragraph (2). A person who is not a party to such an agreement is not liable under that agreement for its breach.

(4) 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.

(5) 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 receivable.

Article 12. *Limitations relating to Governments and other public entities*

Articles 10 and 11 do not affect the rights and obligations of a debtor, or of any person granting a personal or property right securing payment of the assigned receivable, if that debtor or person is a governmental department[, agency, organ, or other unit, or any subdivision thereof, unless:

(a) the debtor or person is a commercial entity; or

(b) the receivable or the granting of the right arises from commercial activities of that debtor or person.]

Remarks

1. Draft article 12 is the result of a decision made at the previous session of the Working Group to ensure that sovereign debtors are not affected by assignments made in violation of anti-assignment clauses included in public procurement and other similar contracts. The Working Group thought that any interference with the legal regime of such contracts should be avoided, since it could seriously affect the acceptability of the draft Convention (A/CN.9/456, para. 115).

2. However, draft article 12 might go beyond its intended purpose of protecting sovereign debtors who do not need such protection or who can be protected by other means (e.g. by a statutory anti-assignment limitation to the extent it is not affected by the draft Convention; on this matter, see remark 4 below and remarks 3 and 4 to draft article 28; for a suggestion as to how to deal in draft article 10 with statutory limitations to the assignment, see A/CN.9/WG.II/WP.102, remark 7 to draft article 12). In addition, the possibility of a contractual limitation to assignment invalidating the assignment as against a sovereign debtor might inadvertently raise the risk of non-collection from a sovereign debtor and thus raise the cost of credit to all sovereign debtors, irrespective of whether they need the protection provided under draft article 12. Moreover, allowing anti-assignment clauses in public procurement contracts to invalidate assignments as against a sovereign debtor could inadvertently raise the cost of credit to small- and medium-size suppliers of goods and services, which would make it even harder for them to compete for public procurement contracts with large suppliers who normally have alternative sources of credit. The Working Group may, therefore, wish to consider revising draft article 12 in order to allow States to enter a reservation with regard to draft articles 10 and 11, if they so wish.

3. Should the Working Group prefer to take this approach, draft article 12 could be revised to read as follows: "If the State in which the debtor or any person granting a personal or property right securing payment of the assigned receivable is located at the time of the conclusion of the original contract has entered a reservation under draft article [...], articles 10 and 11 do not affect the rights and

obligations of that debtor or person." In addition, a new draft article could be added to the final provisions to read along the following lines: "A State may declare at any time that it will not be bound by draft articles 10 and 11 if the debtor or any person granting a personal or property right securing payment of the assigned receivable is located in that State at the time of the conclusion of the original contract and is a Government[, central or local, any subdivision thereof, or any public entity, unless: [insert subparagraphs *(a)* and *(b)*]]."

4. The title of the provision may need to be slightly revised so as to reflect more clearly the fact that it deals with contractual, and not statutory, assignability. The commentary will clarify that, while draft articles 10 and 11 do not deal with statutory limitations to assignment, the substantive law part of the draft Convention is not subject to any mandatory rules of the law applicable outside the draft Convention limiting assignments, since such a result would undermine the certainty achieved by the draft Convention. For example, draft article 8 overrides any rule of law applicable outside the draft Convention, under which an assignment of future receivables is invalid (on mandatory rules and rules reflecting public policy, see also remarks to draft articles 1 and 24). The wording used to reflect sovereign debtors has been modified so that sovereign loans, as well as transactions involving central and local Governments, any subdivisions thereof and public entities would be covered.

5. It may be noted that the Unidroit Convention on International Factoring (Ottawa, 1988; hereinafter referred to as "the Ottawa Convention") allows States to enter a reservation with regard to a rule very similar to draft article 10, but in relation to all types of debtors. Of the six States parties to the Ottawa Convention two have entered such a reservation. In one State party, the rule in the Ottawa Convention is said to have led to a change in the domestic law in the direction of validating assignments in a commercial context despite the existence of anti-assignment clauses in the relevant contracts.

CHAPTER IV. RIGHTS, OBLIGATIONS AND DEFENCES

Section I. Assignor and assignee

Remarks

Unlike the other provisions of the draft Convention which deal with assignment as a transfer of property rights (whether full property or security rights) in receivables, the provisions contained in this section deal with issues that are subject to party autonomy and are normally addressed in the contract of assignment. The usefulness of these provisions lies in the fact that they allocate risks and responsibilities in the absence of an agreement between the parties to the contract of assignment.

Article 13. *Rights and obligations of the assignor and the assignee*

(1) The rights and obligations of the assignor and the assignee as between them 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 14. *Representations of the assignor*

(1) Unless otherwise agreed between the assignor and the assignee, the assignor represents at the time of the conclusion 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 15. *Right to notify the debtor*

(1) Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor a notification of the assignment and a payment instruction, but after notification is sent only the assignee may send a payment instruction.

(2) A notification of the assignment or payment instruction sent in breach of any agreement referred to in paragraph (1) of this article is not ineffective for the purposes of article 19 by reason of such breach. 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.

Remarks

The Working Group may wish to consider moving the first sentence of 15 (2) to draft article 19, since this sentence deals with the debtor's discharge in the case of a notification sent in breach of an agreement between the assignor and the assignee.

Article 16. *Right to payment*

(1) Unless otherwise agreed between the assignor and the assignee and whether or not a notification of the assignment has been sent:

(a) if payment with respect to the assigned receivable is made to the assignee, the assignee is entitled to retain whatever is received in respect of the assigned receivables;

(b) if payment with respect to the assigned receivable is made to the assignor, the assignee is entitled to payment of whatever has been received by the assignor.

(2) If payment with respect to the assigned receivable is made to another person over whom the assignee has priority, the assignee is entitled to payment of whatever has been received by such person.

(3) The assignee may not retain more than the value of its right in the receivable.

Remarks

1. The commentary will explain that "payment" includes both payment in cash and in kind (e.g. returned goods). However, the Working Group may wish to consider the question whether this matter needs to be explicitly clarified in the text of draft articles 16 and 26 by referring to payment "or other discharge" with respect to the assigned receivable. In addition, the Working Group may wish to define proceeds by reference to whatever is received in payment or other discharge of the assigned receivables (which includes proceeds of receivables and proceeds of proceeds). The drafting of draft articles 16 and 26 may be substantially simplified if a definition of proceeds were to be adopted.

2. In order to align paragraph (2) with paragraph (1), the Working Group may also wish to consider reformulating paragraph (2) so as to state clearly that it deals with the right to payment as between the assignor and the assignee and is subject to contrary agreement between those parties. In its current formulation, it would appear that paragraph (2) does not belong in section I of chapter IV or draft article 16, dealing with the relationship between the assignor and the assignee (see remark 3 to draft article 26).

3. In order to ensure that the assignee has a right in any interest for late payment, and not the assignor (a matter that may not be clear in all legal systems), after the word "value" in paragraph (3) words along the following lines may be inserted: "including interest" (see remark 2 to draft article 2 and draft article 26*bis* (2) and (3)).

Section II. Debtor

Article 17. *Principle of debtor-protection*

(1) Except as otherwise provided in this Convention, an assignment does not, without the consent of the debtor, affect the rights and obligations of the debtor, including the payment terms contained in the original contract.

(2) A payment instruction may change the person, address or account to which the debtor is required to make payment, but may not:

(a) change the currency of payment specified in the original contract, or

(b) change the State specified in the original contract, in which payment is to be made, to a State other than that in which the debtor is located.

Article 18. *Notification of the debtor*

(1) A notification of the assignment and a payment instruction are effective when received by the debtor, if they are in a language that is reasonably expected to inform the debtor about their contents. It shall be sufficient if a notification of the assignment or a payment instruction is in the language of the original contract.

(2) A notification of the assignment or a payment instruction may relate to receivables arising after notification.

(3) Notification of a subsequent assignment constitutes notification of any prior assignment.

Article 19. *Debtor's discharge by payment*

(1) Until the debtor receives notification of the assignment, the debtor is entitled to discharge its obligation by paying in accordance with the original contract.

(2) After the debtor receives notification of the assignment, subject to paragraphs (3) to (8) of this article, the debtor is discharged only by paying the assignee or as otherwise instructed.

(3) If 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 first notification received.

(4) If the debtor receives more than one payment instruction relating to a single assignment of the same receivables by the same assignor, the debtor is discharged by paying in accordance with the last payment instruction received from the assignee before payment.

(5) If the debtor receives notification of one or more subsequent assignments, the debtor is discharged by paying in accordance with the notification of the last of such subsequent assignments.

(6) If 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.

(7) 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.

[(8) This article does not affect any ground on which the debtor may be discharged by paying a person to whom an invalid assignment has been made.]

Remarks

1. Paragraph (1) implies that the debtor may discharge its debt by paying the assignee before notification (the debtor "is entitled to"). This result is also obtained under draft articles 8 (1), 9 and 16 (1), according to which the assignment is effective as against the debtor as of the time of the conclusion of the contract of assignment (although formal validity is left to law outside the draft Convention; see

remarks to chapter III). While such a rule may be appropriate in principle, it may negatively affect practices, such as undisclosed invoice discounting or securitization, in which the debtor is expected to continue paying the assignor (A/CN.9/420, paras. 106-108). Thus, the Working Group may wish: to consider introducing an exception to the rule embodied in paragraph (1) as to the practices mentioned; or to revise the basic rule to the effect that before notification the debtor would be discharged only by paying the assignor; or to leave the matter to other law applicable outside the draft Convention. With a view to achieving certainty, the last alternative should be avoided, if possible.

2. The Working Group may wish to provide in paragraph (6) that until the debtor receives the proof requested, it can discharge its debt by paying the assignor. Otherwise, if the debtor's obligation to pay becomes due shortly after notification, the payment obligation would need to be suspended or the debtor would be in default (and be liable to pay damages and interest). The effect of such a rule would be that the assignee would have to provide with the notification adequate proof to the debtor that an assignment took place (which includes a written confirmation from the assignor).

3. In addition, the Working Group may wish to reconsider paragraphs (7) and (8). Paragraph (7) seems to inadvertently allow a debtor who receives notification from an assignee under the draft Convention to pay the person entitled to payment under the law applicable outside the draft Convention (e.g. the assignor, who may be entitled to payment, since the assignment of future receivables or the assignment in violation of an anti-assignment clause may be invalid under that law). Such an approach may have the unintended effect of increasing the risk that the assignee may not be able to collect from the debtor and thus have a negative impact on the cost of credit.

4. The relevant provision of the Ottawa Convention, from which paragraph (7) originates, provides that the Ottawa Convention does not affect "other grounds" based on which the debtor is discharged by paying *the factor* (i.e. the person entitled to payment under the Ottawa Convention, if the notification does not meet the requirements of the Ottawa Convention; however, in factoring, notification is normally given by the assignor and the Ottawa Convention provides that the assignee may notify the debtor only if authorized by the assignor).

5. Thus, the Working Group may wish to revise paragraph (7) so as to ensure that, after notification under the draft Convention from the assignee and possibly subject to the provision of adequate proof, the debtor is discharged only by paying the person entitled to payment under the draft Convention. As to discharge by payment into court and the like, the Working Group may wish to retain it only if several notifications are involved. Such a provision would ensure that, if law outside the draft Convention provides this alternative and the debtor is faced with several notifications, the debtor would not be precluded from being discharged by paying into court or a deposit fund. In such a case, conflicts among several claimants would be settled in accordance with the law applicable to priority by virtue of draft articles 24 to 26.

6. As to paragraph (8), it may be noted that it either states the obvious or inappropriately places on the debtor the risk of the assignment being non-existent or null and void. If paragraph (8) is meant to state the rule that the debtor does not obtain a discharge if the debtor pays an assignee, the assignment to whom was null and void (e.g. because the assignor did not have the capacity to act or was under duress or was defrauded), it is not necessary. If no assignment exists, draft article 19 or the draft Convention as a whole does not apply and it is rather unlikely that any law would allow the debtor to be discharged if the assignment was non-existent or null and void and the draft Convention does not change anything in this regard. This matter may be explained in the commentary. In any case, with the suggested revision of paragraph (6) (see remark 2 above), the risk of the debtor paying an assignee, to whom the assignment was null and void would be substantially reduced. The exceptional cases where nullity of the assignment could result in the debtor having to pay twice may be left to other law (in particular the case of fraud which is not easily addressed in any trade law text). In the case of subsequent assignments, in which nullity would be particularly difficult to discover, the debtor should be able to recover the payment wrongfully made on the basis of breach of implied representations or unjust enrichment principles.

7. If, on the other hand, paragraph (8) is intended to introduce an additional, good faith requirement for the debtor to be discharged, it is inconsistent with the Working Group's decision not to make the debtor's discharge conditional upon the debtor's good faith or the debtor's knowledge of the validity of the assignment (A/CN.9/434, para. 180; for the various arguments, see also A/CN.9/432, paras. 167-172 and A/CN.9/420, paras. 99-104).

8. Thus, the Working Group may wish to delete paragraph (8) and to include in the commentary the explanation that the debtor is not discharged by way of payment to an assignee, the assignment to whom was null and void (on the understanding that this is a very rare case which can be left to other law). Wording along the following lines may be considered:

"(1) Until the debtor receives notification of the assignment, the debtor is entitled to be discharged by paying in accordance with the original contract. After the debtor receives notification of the assignment, subject to paragraphs (2) to (6) of this article, the debtor is discharged only by paying the assignee or, if otherwise instructed in the notification of the assignment or subsequently by the assignee in a writing received by the debtor, in accordance with such instructions.

[insert paragraphs (3) to (5) renumbering them (2) to (4)].

"(5) If the debtor receives notification of the assignment from a person who purports to be an assignee ("purported assignee"), the debtor is entitled to request the purported assignee to provide within a reasonable period of time adequate proof that an assignment has been made and, until such proof is received by the debtor, the debtor is discharged by paying in accordance with the original contract. Adequate proof includes, but is not limited to, any writing emanating from the assignor and indicating that the assignment has taken place.

"(6) Notwithstanding paragraphs (1) to (5), this article does not affect any other ground on which payment by the debtor to:

(a) the person entitled to payment under this Convention; or

(b) in the case of several notifications or payment instructions, to a competent judicial or other authority, or to a public deposit fund discharges the debtor."

Article 20. *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 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.

(3) Notwithstanding paragraphs (1) and (2), defences and rights of set-off that the debtor could raise pursuant to article 10 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 21. *Agreement not to raise defences or rights of set-off*

(1) Without prejudice to the law governing the protection of the debtor in transactions made primarily for personal, family or household purposes in the State in which the debtor is located, the debtor may agree with the assignor in a signed writing not to raise against the assignee the defences and rights of set-off that it could raise pursuant to article 20. 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.

(3) Such an agreement may only be modified by an agreement in a signed writing. The effect of such a modification as against the assignee is determined by article 22 (2).

Remarks

The Working Group may wish to clarify whether the writing referred to in paragraph (3) needs to be signed by both the assignor and the debtor or only by the debtor.

Article 22. *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.

Article 23. *Recovery of payments*

Without prejudice to the law governing the protection of the debtor in transactions made primarily for personal, family or household purposes in the State in which the debtor is located and the debtor's rights under article 20, failure of the assignor to perform the original contract does not entitle the debtor to recover from the assignee a sum paid by the debtor to the assignor or the assignee.

Section III. Other parties

Article 24. *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) An assignee entitled to priority may at any time subordinate unilaterally or by agreement its priority in favour of any existing or future assignees.

Remarks

1. In order to avoid the risk of *renvoi*, the Working Group may wish to include in the text of the draft Convention (possibly in draft article 5) a provision along the following lines: "For the purposes of this Convention, "law" means the law in force in a State other than its rules of private international law" (see article 15 of the European Union Convention on the Law Applicable to Contractual Obligations, Rome, 1980; hereinafter referred to as "the Rome Convention"). Alternatively, the matter may be explained in the commentary.

2. The Working Group may wish to consider the question whether the forum should be able to set aside the rules applicable under draft article 24 if they are manifestly contrary to its mandatory law ("*loi de police*") or to public policy. Such an approach is consistent with normal practice in private international law texts. While it may be rather unlikely that an issue of mandatory law or public policy will arise in relation to a conflict of priority between several assignees receiving the same receivables from the same assignor, the possibility of such an issue arising cannot be excluded. If the Working Group approves this approach, draft articles 30 and 31 should be made applicable to draft article 24, as well as to all the private international law provisions of the draft Convention (which may be

placed in one chapter), draft articles 25 (3) and (4) and 26 (5) could be deleted. Draft article 25 (5) may also be deleted on the understanding that, while draft article 31 may operate only to set aside the applicable law, draft article 30 may have both a negative and a positive function in that it may result both in setting aside the applicable law and in the application of domestic rules as to preferential non-consensual rights.

Article 25. *Competing rights of assignee and creditors of the assignor or insolvency administrator*

(1) Priority between an assignee and the assignor's creditors is governed by the law of the State in which the assignor is located.

(2) In an insolvency proceeding, priority between the assignee and the assignor's creditors is governed by the law of the State in which the assignor is located.

(3) Notwithstanding paragraphs (1) and (2), the application of a provision of the law of the State in which the assignor is located may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.

(4) If an insolvency proceeding is commenced in a State other than the State in which the assignor is located, 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.

(5) If an insolvency proceeding is commenced in a State other than the State in which the assignor is located, any [non-consensual] [preferential] right or interest which under the law of the forum State would have priority over the interest of an assignee has such priority notwithstanding paragraph (2). [A State may deposit at any time a declaration identifying those [non-consensual] [preferential] rights or interests which have priority over the interests of an assignee notwithstanding application of the priority rule set out in paragraph (2).]

(6) An assignee asserting rights under this article has no less rights than an assignee asserting rights under other law.

Remarks

1. In paragraph (2), the term "assignor's creditors" has been substituted for the term "insolvency administrator", since: in some legal systems, the insolvency administrator does not become the holder of the rights of the creditors; and, in some reorganization proceedings, there may be no insolvency administrator (A/CN.9/WG.II/WP.102, remark 1 to draft article 24). However, in view of the fact that, in other legal systems, the insolvency administrator does become the holder of the creditors' rights, a reference to the insolvency administrator should be inserted in paragraph (2).

2. If paragraphs (3) to (5) are retained (see remark 2 to draft article 24), they may need to be reformulated. The application of paragraph (3) should be limited to cases in which an insolvency or other proceeding is commenced in a jurisdiction other than the main jurisdiction of the assignor. If such a proceeding is commenced in the assignor's main jurisdiction, any conflict with the lex loci concursus or the lex fori will be resolved by the rules of that jurisdiction. In paragraph (4), it may need to be further clarified that the assignee with priority retains its priority, but the assignment may be challenged by the insolvency administrator, e.g. as a preferential or a fraudulent transfer (the words "except as provided in this article" may not reflect the intended effect of paragraph (4)). In paragraph (5), the second sentence may be deleted. It is rather unlikely that any State would make a declaration limiting the non-consensual preferential rights that it would wish to preserve.

3. Paragraph (6) may also be deleted. It appears suggesting that, although a conflict of priority is covered by the draft Convention, a law other than the law of the assignor's location may be applicable. Paragraph (6) was originally intended to ensure that an assignee asserting priority under the substantive law provisions of the draft Convention would not have less rights than if it asserted priority under substantive law outside the draft Convention (A/CN.9/455, para. 40; and A/CN.9/445, para. 44). Once the Working Group decided to turn the priority rules of the draft Convention into private international law rules (A/CN.9/445, para. 22), paragraph (6) does not appear to be appropriate.

[Article 26. *Competing rights with respect to payments*

(1) If payment with respect to the assigned receivable is made to the assignee, the assignee has a property right in whatever is received in respect of the assigned receivable.

(2) If payment with respect to the assigned receivable is made to the assignor, the assignee has a property right in whatever is received in respect of the assigned receivable if:

(a) what is received is money, cheques, wire transfers, credit balances in deposit accounts or similar assets ("cash receipts");

(b) the assignor has collected the cash receipts under instructions from the assignee to hold the cash receipts for the benefit of the assignee; and

(c) the cash receipts are held by the assignor for the benefit of the assignee separately from assets of the assignor, such as in the case of a separate deposit account containing only cash receipts from receivables assigned to the assignee.

(3) With respect to the property rights referred to in paragraphs (1) and (2) of this article, the assignee has the same priority as it had in the assigned receivables.

(4) If payment with respect to the assigned receivable is made to the assignor and the requirements of paragraph (2) are not met, priority with respect to whatever is received is determined as follows:

(a) if what is received is a receivable, priority is governed by the law of the State in which the assignor is located;

(b) if what is received is an asset other than a receivable, priority is governed by the law of the State in which it is located.

(5) Paragraphs (3) to (5) of article 25 apply to a conflict of priority arising between an assignee and the insolvency administrator or the assignor's creditors with respect to whatever is received.]

Remarks

1. Unlike draft articles 24 and 25, according to which the issue of priority in receivables and the remedies available to an assignee are left to the law of the assignor's location, paragraphs (1) and (2) are intended to give to the assignee, in certain cases, a proprietary right (right in rem) in proceeds. They are not meant, however, to change the order of priority, which is established in paragraphs (3) and (4). The operation of draft article 26 may be better illustrated with the following examples. In a conflict with respect to proceeds among several assignees of the same receivables, the order of priority will be established according to the law applicable by virtue of paragraphs (3) and (4). In such a case, priority does not depend upon whether any assignee has a right in rem or ad personam (i.e. the senior assignee with a personal claim prevails over a junior assignee with a proprietary claim). In a conflict with respect to proceeds between an assignee and the assignor's creditors or the administrator of the insolvency of the assignor, the order of priority will still be determined by the law applicable by virtue of paragraphs (3) and (4). Whether the assignee with priority in proceeds has a proprietary or a personal claim in such proceeds is also subject to the law governing priority in proceeds under paragraphs (3) and (4), with the exception of the situations addressed in paragraphs (1) and (2), in which the assignee with priority in proceeds is given a proprietary claim in such proceeds.

2. In order to better reflect this understanding, the Working Group may wish to separate issues of priority in proceeds from the question of the remedies available to an assignee with priority and to address the former in a provision containing paragraphs (3), (4) and (5) and the latter in another provision containing paragraphs (1) and (2). The Working Group may also wish to consider the question whether the rule embodied in paragraph (2) could be extended to proceeds other than cash proceeds provided that they meet the requirements of paragraph (2). If such an approach were to be adopted, subparagraph *(a)* could be deleted along with any reference to cash proceeds in subparagraphs *(b)* and *(c)*. In subparagraph *(c)*, the requirement that the proceeds need to be "reasonably identifiable", which is already implied, may need to be stated explicitly.

3. In addition, the Working Group may wish to align paragraphs (1) and (2) with draft article 16 to ensure that the assignee's right to the proceeds will not exceed the value of its right in the receivable. However, complete consistency with draft article 16 (2) may not be feasible, since so far the Working Group has not agreed to give the assignee in the case of payment to a person other than the assignee or the assignor (e.g. a competing assignee or a creditor of the assignor) a right in rem in the proceeds (thus, introducing in draft article 26 a rule along the lines of draft article 16 (2) would not be appropriate). Wording along the following lines may be considered:

"Article 26. *Priority in proceeds*

"(1) Priority among several assignees of the same receivables from the same assignor and between the assignee and the assignor's creditors or the insolvency administrator with respect to whatever is received in payment [, or other discharge,] of the assigned receivable is determined as follows:

(a) if what is received is a receivable, priority is governed by the law of the State in which the assignor is located;

(b) if what is received is an asset other than a receivable, priority is governed by the law of the State in which it is located.

"(2) Paragraphs (3) to (5) of article 25 apply to a conflict of priority arising between an assignee and the assignor's creditors or the insolvency administrator with respect to whatever is received in payment [, or other discharge,] of the assigned receivable.

"Article 26*bis*. *Rights* in rem *in proceeds*

"(1) With the exception of the cases foreseen in paragraphs (2) to (4) of this article, whether an assignee [has a right in rem or ad personam in] [is entitled to claim and retain] whatever is received in payment [, or other discharge,] of the assigned receivable is subject to the law governing priority under article 26 of this Convention.

"(2) If payment [, or other discharge,] with respect to the assigned receivable is made to the assignee, the assignee with priority over the assignor's creditors or the insolvency administrator under article 26 of this Convention has [a right in rem in] [the right to retain] whatever is received up to the value of its right in the receivable[, including interest].

"(3) If payment [, or other discharge,] with respect to the assigned receivable is made to the assignor, the assignee with priority over the assignor's creditors or the insolvency administrator under article 26 of this Convention has [a right in rem] [the right to retain] whatever is received up to the value of its right in the receivable[, including interest,] if:

(a) the assignor has received payment [, or other discharge,] under instructions from the assignee to hold whatever it received for the benefit of the assignee; and

(b) whatever the assignor received is held by the assignor for the benefit of the assignee separately and is reasonably identifiable from assets of the assignor, such as in the case of a separate deposit account containing only cash receipts from receivables assigned to the assignee."

CHAPTER V. CONFLICT OF LAWS

Remarks

1. The Working Group may wish to consider the scope or the purpose of the private international law rules of the draft Convention (on this matter, see A/CN.9/WG.II/WP.102, remarks 18-20 to draft article 1). In principle, it would not be

appropriate to limit the application of private international law rules on the basis of the substantive law notions contained in chapter I (i.e. only to assignments as defined in draft article 2, or only to international transactions as defined in draft article 3 or only if the assignor is located in a Contracting State). If the forum State is a Contracting State, it should be allowed to apply chapter V if the transaction at hand has any international element and irrespective of whether the assignor or the debtor are located in Contracting States or whether the transaction involves an assignment of contractual or non-contractual receivables.

2. Such an approach would allow States that do not have adequate private international law rules on assignments or no rules at all to benefit from the rules contained in chapter V. Admittedly, those rules reflect general principles which would need to be supplemented by other principles of private international law. However, in their generality the provisions of chapter V introduce rules that may be useful for many States and clarify matters (e.g. priority issues) over which a great degree of uncertainty prevails in private international law. Those States that have adequate rules on assignment may always opt out of chapter V.

3. As to the question of whether it is a correct legislative policy to include private international law provisions in a substantive law text, the Working Group may wish to note that complex financing transactions, such as those involving assignments, can only be regulated in a meaningful way if they are regulated in a text that addresses in an as consistent and comprehensive way as possible both substantive and private international law aspects. Unless private international law issues are addressed in chapter V, a great degree of uncertainty will remain with regard to all those issues that the draft Convention has, by necessity, left to law outside the draft Convention (for a list of those issues, see A/CN.9/WG.II/WP.98, remark 2 to draft article 8). In addition, once the priority rules in draft articles 24 to 26 have become generally acceptable, there is no reason to limit their application on the basis of the substantive law notions contained in chapter I, thus missing the opportunity to clarify a matter on which great uncertainty prevails in current private international law texts.

4. Should the Working Group decide to follow this approach, the opening words in draft articles 27 to 29 should be deleted and draft article 1 (3) (which may be placed at the beginning of chapter V) should be revised to read along the following lines: "The provisions of chapter V apply independently of the provisions of chapter I. However, those provisions do not apply if a State makes a declaration under article 34."

5. The hierarchy between the substantive and the private international law rules of the draft Convention, namely that a Contracting State would apply first the substantive law provisions and, only if the matter is not settled by the substantive law provisions, the private international law provisions, may also need to be addressed. Wording along the following lines may be considered for inclusion at the beginning of chapter V: "If the provisions of this Convention outside chapter V do not apply to an assignment, the provisions of chapter V apply". Thus, if the forum is a Contracting State, it would apply chapter V instead of its own private international law rules.

6. Alternatively, the Working Group may wish to consider retaining chapter V, without draft article 27. Draft article 27 addresses the contractual aspects of assignment, which is not the main focus of the draft Convention and may already be sufficiently regulated (even though the principle of freedom of choice of applicable law may not be common to all systems). The Working Group may wish to consider other alternatives, including: to limit the application of chapter V to international transactions as defined in chapter I, without the other limitations of chapter I (for a precedence, see articles 21 and 22 of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit), or only to international transactions with all the limitations as to substantive and territorial application set forth in chapter I. In the latter case: for the reasons mentioned, draft article 27 may be deleted; draft article 29 may also be deleted, since the matter of priority would be sufficiently covered in draft articles 24 to 26; and draft articles 30 and 31 may be cast in the context of draft articles 24 to 26. In such a case, the Working Group may wish to consider whether draft article 28 should be placed in the context of section II of chapter IV, without being subject to an opt-out, since it reflects generally acceptable principles.

Article 27[29].[9] *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 expressly chosen by the assignor and the assignee.

(2) 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 contract of assignment is presumed to be most closely connected with the State in which the assignor has its place of business. If the assignor has more than one place of business, reference is to be made to the place of business most closely connected to the contract. If the assignor does not have a place of business, reference is to be made to its habitual residence.

(3) If the contract of assignment is connected with one State only, the fact that the assignor and the assignee have chosen the law of another State does not prejudice the application of the law of the State with which the assignment is connected if that law cannot be derogated from by contract.

Remarks

In order to more clearly reflect the matters that should be subject to party autonomy, the Working Group may wish to consider substituting for "the contract of assignment" the terms "the conclusion, validity and the rights and obligations of the assignor and the assignee arising under the contract of assignment". In addition, the Working Group may wish to consider whether paragraph (2) is necessary.

[9]The number in square brackets indicates the number of this provision in the annex to document A/CN.9/455, from which the provisions in chapter V and chapter VI, with the exception of the underlined wording in chapter VI, originate.

If the thrust of draft article 27 is to recognize party autonomy without going into any detail, paragraph (2) may not be absolutely necessary, in particular in view of the fact that the transactions intended to be covered are highly negotiated by highly sophisticated parties who normally include a choice of law clause in their contracts. If paragraph (2) is retained and a definition of location is adopted along the lines suggested above (see remark 4 to draft article 5), the third and the fourth sentence of paragraph (2) could be deleted. As to paragraph (3), the Working Group may wish to consider whether it is useful without any detailed rules as to the relevant connecting factors (e.g. characteristic performance under article 4 (2) of the Rome Convention with the fall-back position of article 4 (5) of the Rome Convention if the characteristic performance cannot be determined). Moreover, the Working Group may wish to consider dealing in chapter V with the issue of the form of the assignment (paragraph (1) is intended to deal with substantive validity only; see remarks to chapter III).

Article 28[30]. *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 law governing the receivable to which the assignment relates determines its assignability, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and any question whether the debtor's obligations have been discharged.

Remarks

1. The Working Group may wish to reconsider its decision not to deal with the issue of the law applicable to rights of set-off (A/CN.9/456, 197). Rights of set-off of the debtor against the assignee arise often and are bound to affect the availability and the cost of credit.

2. The general principle as to contractual rights of set-off is that they are governed by the law of the contract from which they arise. This means that the law governing the right of set-off will be the same as the law governing the receivable, if the right of set-off arises from the original contract, and different, if the right of set-off arises from another contract. A rule along those lines would enhance certainty and may have a beneficial impact on the cost of credit. Wording along the following lines may be considered: "Rights of set-off arising from the original contract are governed by the law governing the receivable. Rights of set-off arising from any other contract are governed by the law governing that contract."

3. As to the statutory assignability, it should be noted that the application of the law governing the receivable would not be appropriate in the case of statutory assignability. Such an approach could inadvertently result in allowing the assignor and the debtor to evade possible statutory limitations, which involves matters of mandatory law or public policy, by choosing a convenient law to govern the receivable. Statutory limitations may be aimed at protecting the assignor (as, e.g. in the case of a statutory limitation as to the assignability of wages and pensions) or the debtor (as, e.g. in the case of a limitation as to the assignment of receivables owed by a sovereign debtor). The Working Group will recall that it decided not to include any additional provisions in draft article 28 on the understanding that statutory limitations to assignability, which would normally flow from mandatory law, would be preserved under draft article 30 (A/CN.9/456, para. 117).

4. Whether or not the opening words are retained, if chapter V has a scope beyond chapter I, draft article 28 would cover statutory assignability and contractual assignability for transactions beyond those covered in the draft Convention, while draft article 10 would cover contractual assignability with regard to the transactions falling under the draft Convention. If the opening words are retained and chapter V is subject to chapter I, draft article 10 would cover contractual assignability and draft article 28 would cover statutory assignability (A/CN.9/456, para. 95).

[Article 29[31]. *Law applicable to conflicts of priority*

[With the exception of matters which are settled in chapter IV:]

(a) 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;

(b) priority between an assignee and the assignor's creditors is governed by the law of the State in which the assignor is located;

(c) priority between an assignee and the insolvency administrator is governed by the law of the State in which the assignor is located;

[*(d)* if an insolvency proceeding is commenced in a State other than the State in which the assignor is located, any non-consensual right or interest which under the law of the forum would have priority over the interest of an assignee has such priority notwithstanding subparagraph *(c)*, but only to the extent that such priority was specified by the forum State in an instrument deposited with the depositary prior to the time when the assignment was made;]

(e) an assignee asserting rights under this article has no less rights than an assignee asserting rights under other law.]

Remarks

If chapter V, including draft article 29, is retained, subparagraph *(d)* has to be aligned with draft article 25 (5) (provided also that that provision is retained). As was suggested with regard to draft article 25 (5), subparagraph *(e)* may need to be deleted (see remark 3 to draft article 25).

Article 30[32]. *Mandatory rules*

(1) Nothing in articles 27 and 28 restricts the application of the rules of the law of the forum State in a situation where they are mandatory irrespective of the law otherwise applicable.

(2) Nothing in articles 27 and 28 restricts the application of the mandatory rules of the law of another State with which the matters settled in those articles have a close connection if and in so far as, under the law of that other State, those rules must be applied irrespective of the law otherwise applicable.

Article 31[33]. *Public policy*

With regard to matters settled in this chapter, the application of a provision of the law specified in this chapter may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.

CHAPTER VI. FINAL PROVISIONS

Article 32[41]. *Depositary*

The Secretary-General of the United Nations is the depositary of this Convention.

Article 33[42]. *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) A State may declare at any time that the Convention will not prevail over international conventions or other multilateral or bilateral agreements listed in the declaration, which it has entered or will enter into and which contain provisions concerning the matters governed by this Convention.

Remarks

Conflicts may arise with the Ottawa Convention, the Rome Convention and the EU Insolvency Convention (as to potential conflicts with the Unidroit draft Convention, see remarks 8 to 16 to draft article 4). The potential conflicts with the Ottawa Convention are minimal, since the scope of the Ottawa Convention is narrower than the scope of the draft Convention and, in any case, the provisions of the draft Convention are, to a large extent, similar to those of the Ottawa Convention (with the exception, e.g. of the reservation to the rule on contractual limitations to assignment and the rule on recovery from the assignee of payments made by the debtor). Potential conflicts with the Rome Convention are also minimal since draft articles 27 and 28 are almost identical with article 12 of the Rome Convention. As to the law governing priority, the prevailing view is that article 12 does not address this matter. However, even if draft article 12 addresses issues of priority, neither of the laws applicable under article 12 (i.e. the law chosen by the parties or the law governing the receivable) is appropriate (perhaps with the exception of the assignment of single, present receivables). No significant conflicts appear to arise with the EU Insolvency Convention. The notion of central administration is almost identical with the centre of main interests used in the EU Insolvency Convention (see remark 10 to draft article 5) and that Convention does not affect rights in rem in a main insolvency proceeding (article 5). While the EU Insolvency Convention may affect rights in rem in a secondary insolvency proceeding (articles 2 *(g)*, 4, and 28), draft article 25 (4) would be sufficient to preserve, for example, the right of the assignor's creditors and the insolvency administrator to invalidate the assignment as a fraudulent or preferential transfer. In any case, the rights of the assignor's creditors and the insolvency administrator would be preserved if draft articles 30 and 31 were to replace draft articles 25 (3) and (4). In such a case, the law of the assignor's location could be displaced by the lex concursus or the lex fori (see remark 2 to draft article 24).

Article 34[42*bis*]. *Application of chapter V*

A State may declare at any time that it will not be bound by chapter V.

Remarks

If the Working Group decides to delete draft articles 27 and 29-31, and to move draft article 28 to section II of chapter IV, draft article 34 may be deleted (a new article providing for a reservation to draft articles 10 and 11 with regard to sovereign debtors may be inserted here; see remarks to draft article 12).

[Article 35[42*quater*]. *Other exclusions*

A State may declare at any time that it will not apply the Convention to certain practices listed in a declaration.][10]

Article 36[43]. *Application of the annex*

A State may declare at any time that it will be bound either by [sections I and II or by section III] of the annex to this Convention.

Remarks

If the Working Group substitutes the provisions on the revision and amendment of the draft Convention for the annex (see remarks to the annex below), draft article 36 may be deleted. If the annex is retained, draft article 36 may need to be revised to ensure that a State may opt into the registration-based priority rules (section I), or into the registration rules (section II) or into both (A/CN.9/455, paras. 122 and 131).

[Article 37[44]. *Insolvency rules or procedures not affected by this Convention*

A State may declare at any time that other rules or procedures governing the insolvency of the assignor shall not be affected by this Convention.]

[10]The text underlined in the provisions of chapter VI reflects suggestions made by the secretariat in document A/CN.9/WG.II/WP.102.

Remarks

In view of the general formulation of draft article 25 (4), the Working Group may wish to consider that draft article 37 is not necessary and may be deleted.

Article 38[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.

Remarks

The Working Group may wish to consider the length of the period during which the draft Convention should be open for signature by States. It may be noted that in conventions prepared by UNCITRAL this period ranges between one and two years. In its considerations, the Working Group may take into account: the need to allow sufficient time for States to consider signing the draft Convention, indicating their intention to ratify; and the need not to have a very long period of time which may inadvertently give the impression that there is no urgency in the draft Convention being promptly ratified and entering into force.

Article 39[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 *any time*, 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 40[47]. *Effect of declaration*

(1) Declarations made under articles 34 to 37 and 39 (1) 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 34 to 37 and 39 (1) 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.

[(5) *A declaration or its withdrawal does not affect the rights of parties arising from assignments made before the date on which the declaration or its withdrawal takes effect*.]

Article 41[48]. *Reservations*

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

Article 42[49]. *Entry into force*

(1) This Convention enters into force on the first day of the month following the expiration of six months 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 six months 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 43[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.

[(*3*) *The Convention remains applicable to assignments made before the date on which the denunciation takes effect*.]

ANNEX

Remarks

1. The Working Group may wish to consider whether the annex serves its intended purpose to provide States with some guidance as to a substantive law priority regime. It would appear that, in view of the fact that the annex does not contain one but two recommended priority regimes, both of which need to be supplemented by a substantial number of additional provisions, the annex may not achieve its stated purpose.

2. The Working Group may, therefore, wish to further expand the annex into a more comprehensive set of model legislative rules or, alternatively, if expanding the annex appears to be an exercise beyond the current project, to reformulate it into one or more provisions which would leave the development of an international registration system to a procedure normally foreseen for the revision and amendment of an international convention.

3. Such provisions, which could be added to the final provisions, could read along the lines of articles 32 and 33 of the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules) as follows (changes to the articles mentioned are in italic):

"Article *X*. *Revision and amendment*

"1. At the request of not less than one third of the Contracting States to this Convention, the depositary shall convene a conference of the Contracting States for revising or amending it.

"2. Any instrument of ratification, acceptance, approval or accession deposited after the entry into force of an amendment to this Convention is deemed to apply to the Convention as amended.

"Article *Y*. *Revision of the priority regime*

"1. Notwithstanding the provisions of article *X*, a conference *of Contracting States* only for the purpose of *establishing an international regime for the public filing of notices to address issues of priority arising in the context of assignment of receivables under this Convention* is to be convened by the depositary in accordance with paragraph 2 of this article.

"2. A revision conference is to be convened by the depositary when not less than one fourth of the Contracting States so request. *The depositary shall request all Contracting States invited to the conference to submit such proposals as they may wish the conference to examine and shall notify all Contracting States invited of the provisional agenda and of all the proposals submitted.*

"3. Any decision by the conference must be taken by a two-thirds majority of the participating States. *The conference may adopt all measures necessary to establish an effective international regime for the public filing of notices to address priority issues arising in the context of the assignment of receivables under this Convention. No State shall be bound to participate directly or indirectly in the international regime so established.*

"4. Any amendment adopted is communicated by the depositary to all the Contracting States for acceptance and to all the States signatories of the Convention for information. Such amendment enters into force on the first day of the month following one year after its acceptance by two thirds of the Contracting States. Acceptance is to be effected by the deposit of a formal instrument to that effect with the depositary.

"5. After entry into force of an amendment a Contracting State which has accepted the amendment is entitled to apply the Convention as amended in its relations with Contracting States which have not within six months after the adoption of the amendment notified the depositary that they are not bound by the amendment.

"6. Any instrument of ratification, acceptance, approval or accession deposited after the entry into force of an amendment to this Convention is deemed to apply to the Convention as amended."

Section I. Priority rules based on registration

Article 1[34].[11] *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.

Article 2[35]. *Priority between the assignee and the insolvency administrator or the creditors of the assignor*

[Subject to articles 25(3) and (4) of this Convention and 4 of this annex 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.

Section II. Registration

Article 3[36]. *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.

Article 4[37]. *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 name and address of the assignor and the assignee and a brief description of the assigned receivables.

[11]The numbers in square brackets indicate the numbers of the relevant provisions in document A/CN.9/WG.II/WP.96, from which the provisions of the annex originate. The underlined part of the text reflects suggestions by the secretariat explained in that document.

(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.

Article 5[38]. *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.

Section III. Priority rules based on the time of the contract of assignment

Article 6[39]. *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.

Article 7[40]. *Priority between the assignee and the insolvency administrator or the creditors of the assignor*

[Subject to articles 25(3) and (4) of this Convention and 4 of this annex,] 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.

C. Working paper submitted to the Working Group on International Contract Practices at its thirty-first session: Commentary to the draft Convention on Assignment in Receivables Financing (Part I): note by the secretariat

(A/CN.9/WG.II/WP.105) [Original: English]

CONTENTS

INTRODUCTION

1. The United Nations Commission on International Trade Law, at its twenty-eighth session (1995), decided to entrust the Working Group on International Contract Practices with the task of preparing a uniform law on assignment in receivables financing.[1] The Commission, at that session, had before it a report of the Secretary-General entitled "Assignment in receivables financing: Discussion and preliminary draft of uniform rules" (A/CN.9/412). It was agreed that this report, setting forth the concerns and the purposes underlying this project and the possible contents of the uniform law, would provide a useful basis for the deliberations of the Working Group.[2]

2. The Working Group commenced its work at its twenty-fourth session (November 1995) by considering this report of the Secretary-General.[3] At its twenty-fifth through thirty-first sessions, the Working Group considered revised draft articles prepared by the secretariat,[4] and, at its twenty-ninth through thirty-first sessions, it adopted the draft Convention on Assignment of Receivables in International Trade (exact title remains to be determined).[5]

3. The Commission, at its thirty-second session (1999), expressed appreciation for the work accomplished by the Working Group and requested the Working Group to proceed with its work expeditiously so as to make it possible for the draft Convention, along with the report of the next session of the Working Group, to be circulated to Governments for comments in good time and for the draft Convention to be considered by the Commission for adoption at its thirty-third session (2000). As regards the subsequent procedure for adopting the draft Convention, the Commission noted that it would have to decide at that session whether it should recommend adoption by the General Assembly or by a diplomatic conference to be specially convened by the General Assembly for that purpose.[6]

4. The Working Group proceeded with its work on the understanding that the secretariat would prepare a commentary on the draft Convention which would assist Governments in preparing their comments on the draft text and later in their consideration of the draft Convention for adoption.[7]

5. The present note, which for reasons relating to the timely translation and distribution contains only the first part of the commentary, has been prepared pursuant to that understanding (the second part will be prepared soon after the first part). It provides a summary as to the reasons for the adoption of a certain provision, its main objectives, along with explanations and interpretations of particular terms. It does not give a complete account of the *travaux préparatoires*, including the various proposals and draft provisions that were not retained. For the benefit of those seeking fuller information on the history of a given provision, the commentary lists the references to the relevant portions of the eight session reports of the Working Group.[8]

6. In preparing the commentary, the secretariat has taken into account the fact that it is not a commentary on a final text but that its foremost and immediate purpose is to assist the Working Group in reviewing and finalizing the text. After finalization of the text, the secretariat will prepare a revised commentary to assist Governments in preparing their comments on the draft Convention and later in their consideration of the draft Convention for adoption. In line with the applicable instructions relating to stricter control and limitation of United Nations documents, the text of the

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

[2] Ibid., para. 379. At its twenty-sixth and twenty-seventh sessions, the Commission had considered two other reports of the Secretary-General (A/CN.9/378/Add.3 and A/CN.9/397). For the Commission's discussion of those reports, see ibid. *Forty-eighth Session, Supplement No. 17* (A/48/17), paras. 297-301 and *Forty-ninth Session, Supplement No. 17* (A/49/17), paras. 208-214 respectively.

[3] Report of the Working Group on International Contract Practices on the work of its twenty-fourth session (A/CN.9/420).

[4] The draft articles prepared by the Secretariat are contained in documents A/CN.9/WG.II/WP.87, A/CN.9/WG.II/WP.89, A/CN.9/WG.II/WP.93, A/CN.9/WG.II/WP.96, A/CN.9/WG.II/WP.98, A/CN.9/WG.II/WP.102 and A/CN.9/WG.II/WP.104. The reports of the Working Group are contained in documents A/CN.9/420, A/CN.9/432, A/CN.9/434, A/CN.9/445, A/CN.9/447, A/CN.9/455, A/CN.9/456 and A/CN.9/466.

[5] A/CN.9/455, para. 17; A/CN.9/456, para. 18; and A/CN.9/466, para. [...].

[6] Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), para. 330.

[7] See, e.g. A/CN.9/456, paras. 40, 58-59, 143, 150 and 215; and A/CN.9/455, paras. 80, 84, 87 and 103.

[8] In order to avoid confusion, no special reference is made to previous article numbers which, in the course of the preparation of the draft Convention, were altered several times. However, any earlier number will be apparent from the relevant discussion in the session report.

draft Convention, commented upon, is not reproduced here. It is reproduced in document A/CN.9/WG.II/WP.104, along with the secretariat's remarks and suggestions as to how pending issues could be addressed. Such issues are marked in the text of the draft Convention by square brackets around the relevant provisions. The secretariat has taken the liberty of noting in the commentary additional issues and of making additional suggestions as to how those issues might be addressed.

TITLE AND PREAMBLE

References:

A/CN.9/420, paras. 14-18
A/CN.9/434, paras. 14-16
A/CN.9/445, paras. 120-124
A/CN.9/455, paras. 157-159
A/CN.9/456, paras. 19-21 and 60-65

Commentary

7. The title and the preamble of the draft Convention have not been adopted yet. The main question is whether the reference to financing will be retained (for arguments in favour of one or the other solution, see A/CN.9/WG.II/WP.104, remarks to the title and the preamble).

8. The preamble is intended to serve as a statement of the general principles on which the draft Convention is based and which, under draft article 7, may be used to fill gaps left in the draft Convention. These principles include: the facilitation of both commercial and consumer credit at more affordable rates, which is in the interest of all parties involved, assignors, assignees and debtors; the principle of debtor-protection, according to which the debtor's legal position is not affected unless expressly stated otherwise in the draft Convention; the promotion of the movement of goods and services across borders; the enhancement of certainty and predictability as to the rights of parties involved in assignment-related transactions; the modernization and harmonization of domestic and international laws on assignment, both at the substantive and the private international law level; the facilitation of new practices and the avoidance of interference with current practices; the avoidance of interference with competition.

CHAPTER I. SCOPE OF APPLICATION

Article 1. *Scope of application*

References:

A/CN.9/420, paras. 19-32
A/CN.9/432, paras. 13-38
A/CN.9/434, paras. 17-41
A/CN.9/445, paras. 45-48 and 125-145
A/CN.9/447, paras. 143-146
A/CN.9/455, paras. 41-46 and 160-173
A/CN.9/456, paras. 22-37

Commentary

Structure of chapter I

9. In chapter I, scope-related issues are dealt with in different provisions for the sake of clarity and simplicity in the text; a single provision on scope would be very long and complicated. Draft article 1 defines the substantive scope, only in general terms, as well as the territorial scope of application of the draft Convention. Draft articles 2 and 3 define the substantive scope in more detailed terms (definitions of assignment and internationality respectively). Draft article 5 is not part of chapter I, since the terms defined in this article do not raise scope-related issues but matters of interpretation of various provisions of the draft Convention.

Substantive scope of application

10. Under draft article 1, assignments of international receivables are covered, whether or not the assignments are international or domestic, while assignments of domestic receivables are covered only if the assignments are international. In other words, the assignment of receivables is covered whether or not those receivables arise in the context of international or domestic trade, as long as the assignment itself is international (for comments on internationality, see paras. 40 and 41). Thus, transactions such as factoring and forfaiting of international receivables, as well as securitization of domestic receivables, would be covered (for a non-exhaustive list and a brief description of the practices covered, see paras. 31-39).

11. The draft Convention applies also to subsequent assignments made, for example, in the context of international factoring, securitization and refinancing transactions, provided that any prior assignment is governed by the draft Convention (principle of continuatio juris). Under the principle of continuatio juris, even a domestic assignment of domestic receivables may be brought into the ambit of the draft Convention if it is subsequent to an international assignment. However, unless all assignments in a chain of assignments were made subject to one and the same legal regime, it would be very difficult indeed to address assignment-related issues in a consistent manner. The draft Convention also applies to subsequent assignments that in themselves fall under draft article 1 *(a)*, whether or not any prior assignment is governed by the draft Convention. As a result, the draft Convention may apply only to some of the assignments in a chain of assignments. This result is a departure from the principle of continuatio juris. However, the Working Group considered it necessary to follow this approach since parties to assignments in securitization transactions, in which the first assignment may be a domestic one, should not be deprived of the benefits that may be derived from the application of the draft Convention. This approach is based on the assumption that it would not unduly interfere with domestic practices (on this matter, see paras. 12, 18, 20 and 30). The Working Group did not adopt a suggestion to limit the principle of continuatio juris to those cases in which the internationality would be apparent, since such an approach could introduce an unacceptable degree of uncertainty as to the application of the draft Convention.

12. As a result of covering in the draft Convention international assignments of domestic receivables or even domestic assignments of domestic receivables made in the context of subsequent assignments, business parties in domestic transactions could benefit from increased access to international financial markets and thus to potentially lower-cost credit. At the same time, the interests of domestic assignees would not be interfered with, since, for a conflict between a domestic and a foreign assignee to be covered by the draft Convention, the assignor would need to be located in a Contracting State (draft article 1 *(a)*) and that State, by definition in a domestic assignment of a domestic receivable (draft article 3) would be the State in which both the domestic debtor and the domestic assignee would be located (for a problem that might arise if reference is made in draft article 24 to the place of central administration rather than to the place of business, see A/CN.9/WG.II/WP.104, remarks 3-5 to draft article 1). In addition, the fact that the assignor chose to assign the receivables to a foreign assignee would not bring the debtor under a new and potentially unknown legal regime, since the draft Convention could apply to the debtor's rights and obligations only if the debtor has its place of business in a Contracting State (draft article 1 (3); for the meaning of location of a debtor, see A/CN.9/WG.II/WP.104, remark 4 to draft article 5). In any case, the debtor's rights would not be prejudiced since the draft Convention establishes a sufficiently high standard of debtor protection (i.e. draft articles 17-23).

Territorial scope of application

13. The territorial scope of application of the draft Convention is defined by reference to the assignor's location (whether place of business, place of incorporation or place of central administration has not been decided yet; for the secretariat's suggestions on this matter, see A/CN.9/WG.II/WP.104, remarks 4-19 to draft article 5). The provisions dealing with the rights and obligations of the debtor (i.e. chapter IV, section II) have a different territorial scope to the extent that, for those provisions to apply, the debtor too needs to be located in a Contracting State. In order to ensure sufficient predictability with regard to the application of the draft Convention as far as the debtor is concerned, the Working Group has agreed that the debtor's location needs to be defined by reference to the debtor's place of business (A/CN.9/WG.II/WP.104, remark 4 to draft article 5).

14. This approach to the issue of the territorial scope of the draft Convention is based on the assumption that the main disputes that the draft Convention would be called upon to resolve would be addressed if the assignor (and, only for the application of the debtor-related provisions, the debtor too), is located in a Contracting State. Such disputes could arise with regard to: rights of the assignee against the assignor flowing from the breach of a warranty; enforcement of the receivables by the assignee against the debtor; discharge of the debtor; defences of the debtor towards the assignee; relative rights of the assignee and the administrator in the insolvency of the assignor; relative priority rights of the assignee and a competing assignee; and the effectiveness of subsequent assignments. Additional reasons justifying this approach include: that enforcement would normally be sought in the place of the assignor's or the debtor's location and thus there is no need to make reference to the assignee's location; and that application of the provisions of the draft Convention other than those contained in section II of chapter IV would not affect the debtor and thus there is no need to preclude the application of all the provisions of the draft Convention if the debtor is not located in a Contracting State.

15. As a result of this approach, the territorial scope of application of the draft Convention is sufficiently broad and thus it is not necessary to extend it to cases in which no party may be located in a Contractting State. Such an extension of the territorial scope may be achieved if it is the law of a Contracting State applicable by virtue of the private international law rules of the forum. The Working Group thought that extending the territorial scope in such a way might create uncertainty to the extent that private international law on assignment is not uniform. The Working Group also felt that, in any case, certainty would not be served by such a reference to private international law rules, since parties would not know at the time of the conclusion of a transaction where a dispute might arise and, as a result, which private international law rules might apply. However, the situation is different with regard to the law governing debtor-related issues, since there is a sufficient degree of consensus that those issues should be governed by the law governing the receivable (i.e. the law governing the contract from which the receivable arises). Thus, draft article 1 (3) includes a reference to that law, extending the territorial scope of the debtor-protection provisions of the draft Convention to cover situations in which the debtor might not be located in a Contracting State.

16. Draft article 1 (4) and (5) has not been adopted yet (for the secretariat's comments on these provisions, see A/CN.9/WG.II/WP.104, remarks 1-6 to chapter V and 1-3 to the annex of the draft Convention).

Form of the instrument being prepared

17. The Working Group agreed that a convention would be preferable to a model law since it would result in greater certainty. It was generally felt that such certainty was necessary in achieving the draft Convention's main objective, namely increased access to lower-cost credit. In addition, it was agreed that a convention could better achieve the goal of establishing, along with the Convention on International Factoring (which was prepared by the International Institute for the Unification of Private Law—hereinafter referred to as "Unidroit"—and adopted at a diplomatic conference called by the Government of Canada, Ottawa, 1988—hereinafter referred to as "the Ottawa Convention"), a more comprehensive legal regime with regard to assignment-related transactions.

"Opting-in"/"opting-out"

18. The Working Group decided not to limit the application of the draft Convention to cases in which the assignor and the assignee chose to subject their relationship to the draft Convention. It was generally felt that such a limitation of the scope of the draft Convention was unnecessary. The draft Convention is not aimed at replacing national assignment-related rules but rather at facilitating international

practices, which are currently not sufficiently developed in view of the uncertainty prevailing under national laws (as to the potential effect of the draft Convention on national practices, see paras. 11, 12, 20 and 30). The Working Group may wish to consider the question whether the parties to an assignment, not falling under the ambit of the draft Convention, may choose to apply the draft Convention. Such an opting-in right may or may not exist under private international law rules applicable to the draft Convention, at least to the extent that such a choice of law might affect third parties, a situation that might create uncertainty (for a precedence of an express opting-in provision, see article 1 (2) of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit).

19. Draft article 6 recognizes the right of the parties to the assignment or to the contract giving rise to a receivable to exclude the application of the draft Convention or derogate from or vary the effect of any of its provisions, as long as the rights of third parties are not affected. This approach is based on the assumption that the effects of assignment-related transactions on third parties would normally be governed by national rules of mandatory law that could not be derogated from or varied by agreement of the parties (as to the issue of party autonomy, see paras. 59-60).

Article 2. *Assignment of receivables*

References:

A/CN.9/420, paras. 33-44
A/CN.9/432, paras. 39-69 and 257
A/CN.9/434, paras. 62-77
A/CN.9/445, paras. 146-153
A/CN.9/456, paras. 38-43

Commentary

"Transfer by agreement"

20. Assignment is defined as a "transfer by agreement". This means that the main focus of the draft Convention is on assignment as a way of transfer of property rights in receivables. The contract of assignment or the financing contract is not covered, except where expressly otherwise provided (e.g. draft articles 13-16 and 27; the Working Group may wish to confirm that chapter III addresses the effectiveness of the assignment as a transfer of property rights but not of the contract of assignment). However, other practices involving the transfer of property rights in receivables, such as contractual subrogation or pledge, are covered. Such an approach is appropriate in particular in view of the fact that, in certain legal systems, significant receivables financing transactions, such as factoring, involve a contractual subrogation or pledge rather than the assignment of receivables. An explicit reference to such transactions, contained in an earlier version of draft article 2 (A/CN.9/WG.II/WP.93), was deleted on the understanding that listing such related practices might inadvertently result in excluding some of them (A/CN.9/445, para. 151). As already mentioned above (see paras. 11, 12 and 18), the draft Convention, rather than creating a new type of assignment, is aimed at providing uniform rules on assignment and assignment-related practices with an international element, which, although covered in theory by currently existing national law, could not be sufficiently developed in view of the uncertainty prevailing in national laws. The reference to agreement is intended to exclude assignments by operation of law (e.g. statutory subrogation).

21. In order to avoid any ambiguity as to whether the term "transfer" includes assignments by way of security, the matter is expressly clarified in the second sentence of draft article 2 *(a)*, which creates the legal fiction that, for the purposes of the draft Convention, the creation of security rights in receivables is deemed to be a transfer. However, the draft Convention does not define outright assignments and assignments by way of security. This matter is left to other law applicable outside the draft Convention, since, in view of the wide divergences existing among legal systems as to the classification of transfers, an assignment by way of security could in fact possess attributes of a sale, while a sale might be used as a security device (for a list of issues left to other law, see para. 64).

"From one person to another person"

22. Both the assignor and the assignee can be legal entities or individuals, whether merchants or consumers. Thus, the assignment between individuals is covered, unless they are both consumers and the assignment is made for consumer purposes common to both (draft article 4 *(a)*). As a result, the assignment of credit card receivables in securitization transactions, which has the potential of making lower-cost credit available to manufacturers, retailers and consumers, is covered. The assignment of loans secured by real estate in securitization of mortgages is also covered. In view of the fact that in the draft Convention the singular includes the plural and vice versa, an assignment made by many persons (e.g. joint owners of receivables) to many persons (e.g. a syndicate of financiers) is also covered. In the determination, however, of the territorial scope of application or internationality, the multiplicity of assignors or assignees should be ignored and the assignment by each assignor or to each assignee should be examined independently from assignments by or to another person (the question whether the location of several assignors or assignees could be defined by reference to the location of an authorized agent remains to be considered by the Working Group, see A/CN.9/WG.II/WP.102, remark 14 to draft article 1; as to cases involving multiple debtors, see para. 26).

"Contractual right to payment of a monetary sum"

23. The term "contractual" is intended to ensure that receivables arising from any type of contract are covered, while receivables arising by operation of law, such as tort receivables, tax receivables, or receivables determined in court judgements, are excluded, unless they are confirmed in a settlement agreement. Contractual receivables, the assignment of which is covered by the draft Convention, include receivables arising under contracts for the sale of goods or the provision of services, whether those contracts are commercial or consumer transactions, as well as receivables in the form of royalties arising from the licensing of intellectual property and receivables in the form of credit

balances in deposit accounts or securities transactions (for a brief description of practices, see paras. 31-39).

24. The assignment of other, non-monetary, contractual rights is not covered (e.g. the assignment of the right to performance or the right to declare the contract avoided; as to the right of the assignor to claim damages for breach of contract or interest for late payment, see A/CN.9/WG.II/WP.104, remarks 2 and 3). While the right to performance, e.g. the right of the seller to any goods returned, is not a receivable, the assignee obtains it to the extent that any goods returned by the buyer take the place of the assigned receivable. The matter is addressed in draft articles 16 and 26, according to which payment includes payment both in cash and in kind. However, in order to make this point clearer, the Working Group may wish to insert a reference in draft articles 16 and 26 to a right of the assignee in whatever is received in payment "or other discharge" of the assigned receivable (see A/CN.9/WG.II/WP.104, remark 1 to draft article 16). Assignments of contracts, which involve an assignment of contractual rights and a delegation of obligations, are not covered either. While such transactions may form part of financial arrangements, the financier would normally rely mainly on the receivables. As to the delegation of obligations, the Working Group thought that it goes far beyond the desirable scope of the draft Convention.

"[Owed by] a third person"

25. Apart from the assignor and the assignee, the debtor too could be a legal entity or an individual, a merchant or a consumer. To the extent they are contractual, consumer receivables are covered by the draft Convention, unless they are assigned from one consumer to another and they are thus intended to serve only personal, family or household purposes (draft articles 2 and 4 *(a)*; on this matter, see also paras. 35 and 43).

26. The assignment of receivables, whether whole receivables or parts of receivables, owed jointly (i.e. fully) and severally (i.e. independently) by multiple debtors is also covered, provided that the contract from which the assigned receivables arise (hereinafter referred to as "the original contract") is governed by the law of a Contracting State. If, however, the original contract is not governed by the law of a Contracting State and one or more, but not all, debtors are located in a Contracting State, each transaction should be viewed as an independent transaction and thus debtors who are not located in a Contracting State should not be affected by the draft Convention. Otherwise, the predictability as regards the application of the draft Convention to rights and obligations of debtors, which is one of the main objectives of the draft Convention, could be compromised.

Contract of assignment, financing or other service contract, original contract

27. The draft Convention recognizes the right of the parties to structure their contractual relationship freely so as to meet their various financing needs with a view to remaining competitive in a rapidly changing global marketplace (draft article 6). Thus, the draft Convention does not affect: the contract of assignment, unless it expressly states otherwise (e.g. draft articles 13-16 and 27); the financing or other service contract (which may be the same as the contract of assignment, as, e.g. in factoring transactions, or a separate contract, as, e.g. in securitization transactions); or the original contract between the assignor and the debtor, from which the assigned receivables arise, unless the draft Convention expressly provides otherwise (e.g. draft article 19).

28. The reference to "value, credit or services being given or promised" in return for the receivables assigned, which was contained in an earlier version of the definition of "assignment" (A/CN.9/WG.II/WP.96, draft article 2), has been deleted, since "value, credit or services" are part of the financing contract rather than the assignment. However, the deletion of those words does not change the fact that assignments are covered whether they are outright assignments in which value is given or promised by the assignee to the assignor or to another person affiliated with the assignor or to whom the assignor owed a debt, or assignments by way of security in which credit is given or promised, or assignments in which no financing is offered but services (e.g. book-keeping, collection or insurance against debtor-default, which is often the main or the only element in international factoring transactions). Assignments of receivables would be covered, whether such "value, credit or services" is given or promised not only at the time of the assignment but also at an earlier time. As a result, assignment-related transactions which involve the restructuring of debts of a debtor, being in financial difficulties short of insolvency, would also be covered by the draft Convention.

29. At an early stage in its work, the Working Group considered the question whether the application of the draft Convention should be limited to assignments with a commercial or financing nature or context. The Working Group decided that such a limitation would not be appropriate, since such a limitation: would inappropriately create yet another special regime on assignment, even though one was not needed, and thus inadvertently result in further disunification of the law on assignment; would raise uncertainty since the terms "financing" and "commercial" were not universally understood in the same way, nor was it feasible or desirable to attempt to define them in a uniform way in an international convention; and would unnecessarily exclude from the scope of the draft Convention important transactions such as assignments in international factoring transactions in which only service may be provided (e.g. book-keeping, collection services or insurance against debtor-default). The Working Group preferred to start from a broad scope of application and to exclude transactions that were already well regulated.

30. With regard to the possible impact of such an approach on national law, as already mentioned (see paras. 11, 12, 18 and 20), the draft Convention is intended to cover assignments with an international element and does not adversely affect domestic assignments of domestic receivables (on this matter, see also A/CN.9/WG.II/WP.104, remarks 3-5 to draft article 1; on potential conflicts with the Ottawa Convention, see A/CN.9/WG.II/WP.104, remarks to draft article 33).

Transactions covered

31. The draft Convention covers a wide array of financial transactions. First of all, included are such traditional financing techniques such as factoring, forfaiting and invoice discounting. In these types of transactions, assignors assign to a financier their rights in receivables arising from the sale of the assignors' goods or services. The assignment in such transactions may either be for security or by way of outright transfer with an adjustment in the purchase price depending on the risk and the time involved in the collection of the underlying receivable. Beyond their traditional forms, those transactions have developed a number of variants tailored to meet the various needs of parties to international trade transactions. For example, in addition, or in the place of financing, a number of services may be provided, including collection, book-keeping and insurance against debtor-default. Insurance services are often provided in international factoring, where receivables are assigned to a factor in the country of the assignor ("export factor") and then from the export factor to another factor in the country of the debtor ("import factor") for collection purposes, while the factors do not have recourse against the assignor in the case of debtor-default (non-recourse factoring). All those transactions are covered in the draft Convention regardless of their form.

32. In view of the broad definition of a "receivable" in draft article 2 *(a)* ("contractual right to payment of a monetary sum"), the Convention also covers many other forms of financial transactions used in modern international commerce. These include innovative financing techniques such as securitization, project finance and swaps, as well as transactions involving the financed sale of high-value mobile equipment (on whether some of those practices should be treated differently or excluded altogether from the scope of the draft Convention, see A/CN.9/WG.II/WP.104, remarks 3-16 to draft article 4).

33. In a securitization transaction, an assignor creates receivables through its own efforts. The assignor could be a manufacturing concern selling goods; it could also be a bank extending loans. The assignor assigns, usually by way of an outright transfer, these receivables to an entity specially created for the purpose of buying the receivables and paying their price with the money received from investors to whom it sells the receivables or securities backed by the receivables. This "special purpose vehicle" ("SPV") thus has as its only assets those receivables transferred to it. The segregation of the receivables from the assignor's other assets allows the credit given for the transfer from the assignor to the SPV to be priced solely on the credit of the receivables assigned, and without regard for the assignor's other assets. Immediately after, or concurrently with, such transfer, the SPV assigns an undivided interest in the receivables to investors or issues securities backed by the receivables. As indicated above, the price paid by investors for this interest (or the money lent, which is used to pay back the initial assignor) is linked to the financial strength of the receivables assigned, and not to the creditworthiness of the assignor. Thus, the assignor may be able to obtain more credit than would be warranted on the basis of its own credit-rating. In addition, by gaining access to international securities markets, the assignor may be able to obtain credit at a cost that would be lower than the average cost of commercial bank-based credit. Moreover, the assignment of the receivables by the initial assignor to an entity established for the sole purpose of issuing securities backed by the receivables reduces the risk of insolvency and thus the cost of credit.

34. The draft Convention will similarly apply to an assignment of a project's future cash-flow. In large-scale, revenue-generating infrastructure projects, sponsors raise the initial capital costs by borrowing against the future revenue stream of the project. Thus, hydroelectric dams are financed by the future obligation of payers to pay for electricity, telephone systems are paid for by the future revenues from telecommunications charges and highways are constructed with funds raised through the assignment of future toll-road receipts. Given the draft Convention's applicability to future receivables, these types of project finance may be reduced to transfers, usually for purposes of security, of the future receivables to be generated by the project being financed.

35. In this context, it should be emphasized that the draft Convention's exclusion of assignments made for personal, family or household purposes will not act to exclude consumer receivables (the transaction by which the receivable arises, e.g. the creation of an obligation by a consumer such as that represented by a utility bill, is not an assignment). Only the transfer of the right to receive that payment is an assignment, and the transfer by the utility company to a financier or SPV would not be for personal, family or household purposes (on this matter, see paras. 25 and 43). In addition, it should be noted that toll-road receipts would be contractual receivables falling under the ambit of the draft Convention since they arise from contracts concluded de facto between operators and users of highways.

36. Swaps and derivatives transactions will also come within the draft Convention's ambit. A "swap" is basically a two-party transaction in which different parties' creditworthiness and willingness to take financial risks are exploited. In the traditional case, a creditworthy entity borrows money at a fixed rate. A less-secure entity borrows a similar sum, but its financial standing only permits it to borrow in credit markets at a variable rate. Through a financial intermediary, the two entities "swap" their respective obligations, and agree to indemnify and hold each other harmless, should either party default. There is a fee paid for the swap, with the end result that the less-creditworthy entity, for a fee, can obtain credit at a fixed rate. In view of the fact that the financiers lending the money are invariably part of these transactions (otherwise the swapping would likely be an event of default), their transfer of these rights to receive money brings these types of transactions within the ambit of the draft Convention.

37. Derivatives are similar to swaps in that obligations of debtors are divided and sold among financial and other entities. For example, the first five years of interest payments on a 30-year bond might be packaged and sold to investors, as might be the last five years of such payments. Given the different periods of time, these payment streams present different risks which attract investors, creating a market for such instruments. The trading of such rights to money is directly within the ambit of the draft Convention.

38. Even less traditional transactions are covered by the draft Convention. Loan syndications and participations, for example, are complex forms of assigning the debtor's contractual obligation to pay the debt. All forms of loan syndications, in which the participant receives some right to the debtor's contractual obligation to pay, come within the scope of the draft Convention. The transaction may take the common form of a bank loan, or it may take the form of public financing of some project or equipment acquisition. Thus, transfers of certificates of indebtedness (being contractual obligations to pay) secured by aircraft would be covered by the draft Convention, as would participations in equipment trusts. Indeed, if the initial financing of mobile equipment, such as aircraft, is secured by future revenues, the draft Convention will also apply since the transfer of those receivables by way of security will effectively be a transfer of the customer's contractual obligation to pay. In this context, it should be noted that, if negotiable bonds represent the obligation to pay, their transfer is not covered by the draft Convention by virtue of the exclusion of the transfer of negotiable instruments contained in draft article 5.

39. Similarly, assignments of bank accounts (representing the depository bank's obligation to pay out on such accounts) or assignments of insurance policies (representing the insurance company's contingent obligation to pay upon loss) will also be covered. Again, such transfers may be outright transfers, such as when portfolios of bank accounts or insurance policies are transferred between firms or within a corporate structure. They may also be transfers by way of security, such as insurance premium loans or loans secured by a deposit in a commercial bank.

Article 3. *Internationality*

References:

A/CN.9/420, paras. 26-29
A/CN.9/432, paras. 19-25
A/CN.9/445, paras. 154-167
A/CN.9/456, paras. 44 and 45 and 226-227

Commentary

40. Under the draft Convention, once a receivable is international, its assignment is always covered by the draft Convention. However, even if a receivable is domestic, its assignment may be covered by the draft Convention, if it is international or it is part of a chain of assignments which includes an earlier international assignment (on this matter, see para. 10, as well as A/CN.9/WG.II/WP.104, remarks to draft article 3). The meaning of the term "location" and the issue of location of multiple assignors and assignees have not been decided yet (for the secretariat's suggestions with regard to this matter, see A/CN.9/WG.II/WP.104, remarks 3-10 to draft article 5).

41. Internationality of a receivable is determined at the time of the conclusion of the original contract. This approach is based on the assumption that at that time the creditor (potential assignor) would need to know which law might apply in order to be able to assess the risks involved in a transaction and to determine whether to extend credit to the debtor and on what terms. However, as a result of this approach, parties to an assignment may not be able to determine at the time of the assignment whether the draft Convention will apply if future receivables are involved (i.e. receivables arising from contracts not in existence at the time of assignment). On the other hand, internationality of an assignment is determined at the time it is made. Thus, the parties will always be able to predict at the time of the assignment whether the draft Convention will apply or not.

Article 4. *Exclusions*

References:

A/CN.9/432, paras. 18, 47-52, 106 and 234-238
A/CN.9/434, paras. 42-61
A/CN.9/445, paras. 168-179
A/CN.9/456, paras. 46-52

Commentary

42. In view of its decision that the scope of application of the draft Convention should be as broad as possible, the Working Group agreed that certain practices that did not need to be regulated should be excluded.

Assignments for consumer purposes

43. Subparagraph *(a)* is intended to exclude from the scope of the draft Convention assignments from a consumer to a consumer, since such assignments are of no practical significance (as to a secretariat suggestion to rephrase subparagraph *(a)* or even to delete it, see A/CN.9/WG.II/WP.104, remark 1 to draft article 4). However, subparagraph *(a)* does not exclude assignments from a consumer to a merchant. Such assignments of consumer receivables form part of significant practices, such as securitization of credit card receivables, the facilitation of which has the potential of increasing access to lower-cost credit by manufacturers, retailers and consumers and, as a result, could facilitate international trade in consumer goods. While covering the assignment of consumer receivables, the draft Convention is not intended to override consumer-protection law. Where necessary, the draft Convention makes explicit reference to this principle. For example, under draft articles 21 (1) and 23, a consumer-debtor cannot waive any defences and rights of set-off and has a right to recover payments from the assignee, if the consumer-protection law applicable in the country of the debtor so provides (for anti-assignment clauses in a consumer context, see paras. 83 and 86).

Assignments of negotiable instruments

44. Subparagraph *(b)* excludes assignments made by endorsement and delivery of a negotiable instrument, such as a bill of exchange or a promissory note or a cheque, or by mere delivery of an instrument, such as a bearer document. The underlying reason for this exclusion is the need to avoid interfering with practices well regulated in national

law and international texts. The draft Convention refers to the form of transfer rather than to the documentary nature of the receivable since: such a reference is adequate in protecting the negotiability of an instrument and the interests of a protected holder; it would be very difficult to reach agreement on a uniform definition of the term "documentary receivable"; and there is no need to exclude the assignment of contractual receivables on the sole ground that they have been incorporated in a negotiable instrument for the purpose of obtaining payment by way of summary proceedings in court, if necessary.

Assignments of receivables in corporate buyouts

45. Subparagraph *(c)* is aimed at excluding assignments made in the context of the sale of a business as a going concern, if they are made from the seller to the buyer. Such assignments are excluded as they are normally regulated differently by national laws dealing with corporate buyouts and are not of a financing nature. However, assignments made to an institution financing the sale are not excluded.

Other assignments

46. In the course of its work, the Working Group considered for exclusion other types of assignments such as assignments by operation of law, assignments as gifts, assignments of wages, assignments of contractual rights in general, assignments of insurance premiums, assignments of rents from real estate and equipment and assignments of balances in deposit accounts. As to assignments by operation of law, it should be noted that they are excluded in view of the definition of "assignment" by reference to a "transfer by agreement". In view of the fact that consideration was thought to be part of the contract of assignment, which, with the exception of draft articles 13 to 16 and 27, is not addressed in the draft Convention, the Working Group decided not to address assignments as gifts. As to the assignment of wages, the Working Group decided to leave the matter to other law. If such assignments are prohibited under national law, the draft Convention does not affect such a prohibition. If, however, such assignments are not prohibited under national law, with a view to preserving significant practices, such as the financing of temporary employment services, the draft Convention does not do anything to invalidate them (as to the law applicable to statutory assignability, see A/CN.9/WG.II/WP.104, remarks 3-4 to draft article 28). The Working Group decided to cover assignments of insurance premiums and of rents arising from leases of real estate and equipment, as well as assignments of credit balances in deposit accounts (however, as to the exact treatment of some of those transactions and possible exceptions, see A/CN.9/WG.II/WP.104, remarks 3-16 to draft article 4).

47. In the interest of enhancing the acceptability of the draft Convention, paragraph (2), which appears within square brackets since it has not been adopted yet by the Working Group, is intended to ensure that States are given a possibility to exclude further practices. Such an approach may be necessary if no agreement is reached on the practices to be excluded in paragraph (1) or in order to address concerns that might arise in the future. However, a possible disadvantage of such an approach would be that the scope of the draft Convention could vary from State to State, with the result that, in view of the multiplicity of parties involved and the possibility that one or more but not all possibly relevant States might have made a declaration, the exact scope of the draft Convention would not be easy to ascertain. This result in itself could increase the legal cost and thus the final cost of a transaction (on this matter, see A/CN.9/WG.II/WP.104, remarks 7 and 16 to draft article 4).

CHAPTER II. GENERAL PROVISIONS

Article 5. *Definitions and rules of interpretation*

References:

A/CN.9/420, paras. 52-60
A/CN.9/432, paras. 70-72, 94-105
A/CN.9/434, paras. 78-85, 109-114, 167 and 244
A/CN.9/445, paras. 180-190
A/CN.9/456, paras. 53-78

Commentary

"original contract"

48. The term is defined since it is referred to in draft articles 5 *(b)*, 5 *(k)* (iii), 17 (1), 17 (2) *(a)* and *(b)*, 18 (1), 19 (1), 20 (2), 22 (2) *(b)* and (23). With the contract of assignment and the financing or other service contract, which may be the same or a different contract, the original contract is part of the basic chain of contractual relationships involved in an assignment-related transaction. With the exception of those provisions which expressly state otherwise (e.g. draft article 19), the draft Convention does not affect the rights and obligations of the debtor as they are stipulated in the original contract (draft article 17).

"deemed to arise when the original contract is concluded"

49. With a view to enhancing certainty, the draft Convention provides a uniform rule on the time when a receivable is deemed to arise. Such a rule is essential in order to determine the internationality of a receivable and the effectiveness of a bulk assignment. The time when the original contract is concluded is the most appropriate point of time because at that point the identity of the creditor and the debtor, as well as the legal source of the receivable and its amount, are known. The time at which a receivable becomes due or the original contract becomes enforceable were thought to be inappropriate in this regard, since delaying the time at which a receivable arose and could be used for obtaining credit could have an adverse impact on the availability of credit. The term "concluded" refers to the conclusion of the contract, the exact meaning of which is left to law applicable outside the draft Convention. In any case, "conclusion" does not refer to the performance of the contract (for a secretariat drafting suggestion to delete subparagraph *(b)* and to refer in draft articles 3 and 8 (1) *(b)* and (2) directly to the time of the conclusion of the original contract, see A/CN.9/WG.II/WP.104, remark 1 to draft article 5).

"existing" and "future" receivable

50. The terms "existing" and "future" receivable are referred to in draft articles 8 (effectiveness of an assignment) and 9 (time of assignment). The draft Convention does not introduce any limitation with regard to the types of future receivables the assignment of which is covered. Thus, the entire range of future receivables is covered in the definition, including conditional (i.e. receivables that might arise subject to a future event that might take place or not) and purely hypothetical receivables (i.e. receivables that might arise from an activity not initiated by the assignor at the time of the assignment). However, draft article 8 introduces a limitation as to the effectiveness of the assignment of a future receivable, by requiring that the future receivable should be identifiable, at the time of the conclusion of the original contract, as a receivable to which the assignment relates. Once this requirement is met, the future receivable is considered as transferred at the time of the conclusion of the contract of assignment. However, this result should not prejudice the rights of third parties (see para. 70).

"receivables financing"

51. This definition, which appears in square brackets, has not been adopted by the Working Group (for a secretariat suggestion to delete this definition and to, possibly, refer to receivables financing in the preamble, see A/CN.9/WG.II/WP.104, remark 1 to draft article 5).

"writing"

52. The definition is intended to include other than paper-based means of communications which can perform the same functions as a paper communication (e.g. provide tangible evidence, serve as a warning to the parties with regard to the consequences, provide a legible communication, authentication and sufficient assurances as to its integrity). It is inspired by articles 6 and 7 of the UNCITRAL Model Law on Electronic Commerce and reflects the two distinct notions of "writing" and "signature" (or "signed writing").

53. The draft Convention requires a writing for the notification of the assignment and a signed writing for the waiver of the debtor's defences (draft article 21 (3), however, may need to clarify whether the signature of both the assignor and the debtor is required or only that of the debtor; see A/CN.9/WG.II/WP.104, remark to draft article 21). Writing is also required for declarations by States and for certain registration-related acts. This approach is based on the assumption that the need for higher assurances as to the authenticity of communications should be assessed differently depending on the context in which the communication is made.

54. "Accessible" is meant to imply that the communication is readable and interpretable; "usable" refers not only to use by a physical person but also by a computer; and "subsequent reference" establishes a standard which is akin to that implied by a notion such as durability (while not referring to the strict interpretation given to the notion of durability in certain legal systems as equivalent to non-alterability) but more objective than that implied by notions such as readability or intelligibility (see Guide to Enactment of the Model Law, para. 50). Signature is defined by reference to the identification of the signer and indication of the signer's approval of the content of the communication.

"notification of the assignment"

55. Under subparagraph *(f)*, a notification meets the requirements of the draft Convention if it is in writing and provides a reasonable description of the assigned receivables. What is a reasonable description is a matter to be determined in view of the circumstances. However, reasonable would include descriptions along the following lines: "all my receivables from my car business" and "all my receivables as against my clients in countries A, B and C". There is no requirement that the notification identify the person to whom or for whose account or the address to which the debtor is to pay. As a result, a notification containing no payment instruction is effective under the draft Convention. However, in view of the fact that, under the draft Convention, a notification changes the way in which the debtor may discharge its debt, parties notifying the debtor would be encouraged to include in their notification such a payment instruction. The Working Group based the discharge of the debtor on the notification rather than on the payment instructions in order to avoid confusing the debtor in cases in which the two communications might be sent separately or in which several communications might be sent to the debtor by several persons.

"insolvency administrator" and "insolvency proceeding"

56. Subparagraphs *(g)* and *(h)* have been inspired by the definitions of "foreign proceeding" and "foreign administrator" contained in article 2 *(a)* and *(d)* of the UNCITRAL Model Law on Cross-Border Insolvency. They are also consistent with articles 1 (1), 2 *(a)* and *(b)* of the European Convention on Insolvency Proceedings. By referring to the purpose of a proceeding or to the function of a person, rather than using technical expressions that may have different meanings in legal systems, the definitions are sufficiently broad to encompass a wide range of insolvency proceedings, including interim proceedings. This approach is intended to avoid that a Contracting State recognizes as an insolvency proceeding or administrator a proceeding or person which does not have that character under the lex loci concursus, or is unable to recognize as an insolvency proceeding or administrator a proceeding or person which has that character under the lex loci concursus.

"priority"

57. 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 (as to whether "priority" covers the question whether an assignee has a claim in rem or ad personam, see A/CN.9/WG.II/WP.104, remark 3 to draft article 5). Whether the person with priority may retain all the proceeds of payment or turn over any remaining balance after payment of its claim to the next person in the

line of priority or to the assignor depends on whether an outright assignment or an assignment by way of security is involved; this matter is left to law applicable outside the draft Convention. The definition does not refer to the right to payment since, while this expression might be appropriate for assignments by way of security, it might be restrictive in outright assignments in which the assignee may, for example, have a right to receive any goods returned by the debtor to the assignor. However, the Working Group may wish to consider whether this matter might be better addressed if wording along the following lines is inserted in subparagraph *(i)*: "the right to payment or other discharge".

"location"

58. The Working Group has not reached a decision yet as to the meaning of the notion of "location" (for the secretariat's suggestions, see A/CN.9/WG.II/WP.104, remarks 4-10 to draft article 5).

Article 6. *Party autonomy*

References:

A/CN.9/432, paras. 33-38
A/CN.9/434, paras. 35-41
A/CN.9/445, paras. 191-194
A/CN.9/456, paras. 79 and 80

Commentary

59. Article 6, which is modelled on article 6 of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980; hereinafter referred to as "the United Nations Sales Convention") provides broad recognition of the principle of party autonomy. Unlike article 6 of the United Nations Sales Convention, however, draft article 6 does not allow the assignor and the assignee to exclude the draft Convention as a whole. The reason for this approach is that, as the draft Convention deals with the rights of parties other than the assignor and the debtor, an exclusion of the application of the draft Convention would affect the rights of third parties (i.e. in the context of an agreement between the assignor and the assignee, the debtor, the assignor's creditors and the insolvency administrator and, in the context of an agreement between the assignor and the debtor, the assignee, the assignor's creditors and the insolvency administrator). Such a result would not only go beyond any acceptable notion of party autonomy but would also introduce an undesirable degree of uncertainty and could thus frustrate the main objective of the draft Convention to facilitate increased access to lower-cost credit and to provide, at the same time, an adequate debtor-protection system. Thus, the assignor and the assignee may only vary or derogate from draft articles 13 to 16 and 27, while the assignor and the debtor are free to vary or derogate from draft articles 17 to 23, as long as the rights of the assignee or other third parties are not prejudiced.

60. Like article 6 of the United Nations Sales Convention, draft article 6 requires an agreement, i.e. two corresponding declarations of intent, for the effective derogation from the draft Convention. Such an agreement may be explicit or implicit. A typical example of an implicit derogation is where the parties refer to the law of a non-Contracting State or to the national law of a Contracting State. The derogation is effective, if the choice of law by the parties is valid under the private international law rules of the forum. If the choice of law is invalid, in the absence of any indications, it cannot be generally assumed that the parties intended to derogate from the Convention, regardless of whether or not their choice of law was valid. It cannot be generally assumed either that, had the parties known that their choice of law would be invalid, they would wish that the proper law of the contract would apply to their contract. An effective derogation does not require that the parties reach an agreement on the law applicable to the matters on which they derogated from the provisions of the draft Convention. In such a case, it should be assumed that the parties do not wish to have recourse to national law but wish any gaps to be filled in accordance with draft article 7 (2). If parties have agreed on the law applicable to the issues on which they derogated from the draft Convention, that law should be applied in a way consistent with the draft Convention, unless the derogation is so great that a particular matter can no longer be regarded as falling under the draft Convention.

Article 7. *Principles of interpretation*

References:

A/CN.9/432, paras. 76-81
A/CN.9/434, paras. 100 and 101
A/CN.9/445, paras. 199 and 200
A/CN.9/456, paras. 82-85

Commentary

61. This article, inspired by article 7 of the United Nations Sales Convention, deals with the interpretation of and the filling of gaps in the draft Convention. With regard to the interpretation of the draft Convention, draft article 7 (1) refers to three principles, i.e. the international character of the text, uniformity and good faith in international trade. These principles are common to most UNCITRAL texts. The reference to the international character or source of the text should lead a court to avoiding to interpret the draft Convention on the basis of notions of national law, unless the meaning of a term used in the draft Convention is clearly identical with its meaning under a particular national law. The need to preserve uniformity can be served only if courts or arbitral tribunals apply the general principles underlying the draft Convention and have regard to decisions of courts or tribunals in other countries. The Case Law on UNCITRAL Texts (CLOUT), a system of reporting case law on UNCITRAL texts, has been established by UNCITRAL exactly with the need to preserve uniformity in mind (CLOUT is available in paper form in the six official languages of the United Nations and through the UNCITRAL website, http:\\www.uncitral.org, in English, Spanish and French; depending on the resources available, the other language versions will also be made available in the future).

62. The reference to good faith may apply not only to the interpretation of the draft Convention but also to the conduct of the parties. However, while the principle of good faith would appropriately be applied to the contractual relationship between the assignor and the assignee or the assignor and the debtor, it could undermine the certainty of the draft Convention if applied to the relationship between the assignee and the debtor or the assignee and any other claimant. For example, if the principle of good faith prevailing in the forum State were to apply to the assignee-debtor or the assignee-third party relationship: the debtor, who might have paid the assignee after notification, may have to pay again if, e.g. the debtor knew about a previous assignment; and the law applicable under draft article 24 might be disregarded if it does not respect the principle of good faith as it may be understood in the forum State.

63. As to gap-filling, the rule is that, if matters are governed by the draft Convention (chapter I) but not expressly settled in it, they are to be decided in accordance with the general principles on which the draft Convention is based. Such principles include notably the principles expressly mentioned in the preamble or enshrined in a number of provisions of the draft Convention (e.g. the principle of facilitation of increased access to lower-cost credit and the principle of debtor protection). Recourse to private international law rules is permitted only if: there is no principle on the basis of which a particular matter could be resolved; or the matter is not governed by the draft Convention at all.

64. Matters not governed by the draft Convention and left to other law include: the meaning of an outright assignment and an assignment by way of security; the question of the form of the contract of assignment; the accessory or independent character of a security right, which is the basis for determining whether it is transferred automatically with the receivables the payment of which it secures, or whether a new act of transfer is needed; the consequences of a breach of representations by the assignor; to a large extent, the assignability of a receivable (the draft Convention covers it to some extent in that it specifies a number of receivables that are assignable, including future receivables and receivables not identified individually, and in that it deals with contractual limitations to assignment, but leaves other types of receivables and other statutory limitations to assignment unaddressed); the question whether the assignor is liable towards the debtor for assigning its receivables in violation of an anti-assignment clause; the debtor's obligation to pay (the draft Convention deals with the debtor's discharge only); the discharge of the debtor on grounds other than those specified in the draft Convention (e.g. by paying the rightful claimant if the notification received does not meet the requirements of the draft Convention); the defences and rights of set-off that the debtor may raise against the assignee (the draft Convention provides that the debtor has against the assignee the same defences and rights of set-off that it would have against the assignor, without, however, specifying them); agreements between the debtor and the assignee by which the debtor waives its defences and rights of set-off towards the assignee; questions of priority among several assignees of the same receivables, between the assignee and the insolvency administrator and between the assignee and the assignor's creditors; and the question whether the right of the assignee in proceeds is a right ad personam or in rem.

65. In view of the possibility that it may be difficult to determine whether a matter is governed but not expressly settled in the draft Convention or not governed at all, the Working Group may wish to consider the question whether a provision along the lines of article 4 of the United Nations Sales Convention, listing expressly the matters covered therein, would be appropriate for inclusion in the draft Convention.

66. The Working Group may also wish to clarify whether gaps left in the private international law provisions of the draft Convention are to be filled in accordance with the substantive or the private international law principles underlying the draft Convention. In the absence of such principles, such gaps would be filled in accordance with the private international law of the forum.

CHAPTER III. EFFECTS OF ASSIGNMENT

Form of assignment

References:

A/CN.9/420, paras. 75-79
A/CN.9/432, paras. 82-86
A/CN.9/434, paras. 102-106
A/CN.9/445, paras. 204-210
A/CN.9/456, paras. 86-92

Commentary

67. The Working Group considered a wide variety of form requirements, ranging from written form (with or without any signature requirements) to the absence of any form (the possibility of leaving the matter to law applicable outside the draft Convention was also considered). While the widely prevailing view was that purely oral assignments should be invalidated, at least as against third parties, the Working Group was not able to reach agreement on this matter and decided to delete the provision dealing with form. The Working Group took this decision on the understanding that the matter is addressed: with respect to the mutual interests of the assignor and the assignee, in draft article 6, which enshrines party autonomy; with respect to the interests of the debtor, in draft article 19 (in the absence of written notification of the assignment, the debtor's right to discharge its obligation in accordance with the original contract is not affected) and in draft article 19 (general principle of debtor-protection); and with respect to the interests of third parties, in draft articles 24 to 26 (priority rules).

68. However, in draft articles 24 to 26 it is not clear that the law of the assignor's location governs form. As a result and in view of the fact that formal validity is a prerequisite for priority, the assignee, in order to ensure priority, would have to meet the requirements of the law of the assignor's location and the law governing formal validity, which may be difficult to determine (for a secretariat suggestion to include in the text a private international law provision on form, see A/CN.9/WG.II/WP.104, remarks to chapter III).

Specifying the law applicable to formal validity would provide a degree of certainty. However, it would leave to the law applicable: the question whether purely oral assignments would be valid, thus allowing possible abuse or fraudulent collusion between an assignee and the assignor, particularly in situations where the assignor might become insolvent; the question whether stamp duties are payable for the contract of assignment to be valid, which would affect the overall cost of the transaction; and the question of form of an assignment of receivables backed by a security right, which might be subject to the law governing the security right (on this matter, see para. 93).

Article 8. *Effectiveness of bulk assignments, assignments of future receivables and partial assignments*

References:

A/CN.9/420, paras. 45-60
A/CN.9/432, paras. 93-112 and 254-258
A/CN.9/434, paras. 122 and 124-127
A/CN.9/445, paras. 211-214
A/CN.9/456, paras. 93-97

Commentary

Paragraph (1)

69. As a matter of principle, draft article 8 validates assignments (i.e. transfers, not contracts of assignment) of future receivables, bulk assignments and assignments of parts of or undivided interests in receivables. There are certain qualifications to this principle. While the assignment is effective as against the debtor as of the time it is made, before receiving notification in writing, the debtor may refuse to pay the assignee and discharge its debt by paying in accordance with the original contract (the debtor may discharge its debt by paying the assignee, even before receiving written notification; in such a case, however, the debtor takes the risk of having to pay twice, if it is later proven that no assignment took place).

70. A second qualification to the above-mentioned principle is that the effectiveness of an assignment as against third parties is left to the law applicable to priority under draft articles 24 to 26. Thus, draft article 8 is not intended to: validate the first assignment in time while invalidating any further assignment of the same receivables by the same assignor; or to ensure that the assignee will prevail over an insolvency administrator on the sole ground that the assignment took place before the effective date of the insolvency proceeding. In order to avoid inadvertently leaving the effectiveness of future assignments altogether to the law applicable to priority, the Working Group decided to delete language in draft article 8 that would have made draft article 8, as well as draft article 9, subject to draft articles 24 to 26. This decision was taken on the understanding that the combined application of draft articles 8 to 12 and 24 to 26 would lead to the same result, namely that the provisions of chapter III are not intended to affect priority issues, since those issues are dealt with in draft articles 24 to 26.

"existing or future receivables"

71. The assignment of future receivables in bulk is at the heart of modern receivables financing practices. Yet great uncertainty exists as to the validity of such assignments. The draft Convention, therefore, places significant emphasis on the effectiveness of the assignment of future receivables and of bulk assignments in particular. At an early stage in its work, the Working Group noted that the validation of the assignment of conditional receivables and of purely hypothetical receivables might result in a business entity assigning all its claims for the entire duration of its existence, a practice that might run counter to public policy in certain countries (as to the range of future receivables covered, see para. 49). However, the Working Group considered that a blanket exclusion of conditional or hypothetical receivables from the scope of the draft Convention could hamper significant practices, such as those involving the assignment of the cash-flow of a public-infrastructure project for financing purposes. Having carefully considered the matter, the Working Group decided to introduce the requirement, contained in draft article 8 (1), that the receivables should be identifiable when they arise (i.e. when the original contract is concluded) as receivables to which the assignment relates. This requirement is intended to provide appropriate recognition, on the one hand, of the economic need to allow bulk assignments of various types of future receivables and, on the other hand, of the need to protect assignors against the risks that might result from unlimited freedom to assign all conceivable future receivables.

"one or more"

72. While the focus of the draft Convention is on the assignment of a large volume of low-value receivables (involved, e.g. in factoring of trade receivables or in securitization of credit card receivables), the assignment of single, large-value receivables (involved, e.g. in loan syndication) is also validated (as to the question whether anti-assignment clauses and priority issues should be treated differently in the case of an assignment of single receivables, see A/CN.9/WG.II/WP.104, remarks 3-7 to draft article 4).

"is effective"

73. The result of the effectiveness of an assignment depends on whether an outright assignment or an assignment by way of security is involved, which is a matter left to law applicable outside the draft Convention. In the case of an outright assignment, "is effective" means that the assignment transfers full property in the receivable. This means: that the assignee is entitled to retain any surplus remaining after the satisfaction of its claim against the assignor; and that, in the case of debtor-default, the assignee has no recourse against the assignor. In the case of an assignment by way of security, "is effective" means: that the assignee has to turn over to the next claimant in line of priority or to the assignor any remaining surplus; and that, if the debtor fails to pay, the assignee can turn against the assignor and demand payment for the credit or the services extended to the assignor in return for the assigned receivables.

74. As a matter of expression, the term "effective" was thought to be preferable to the term "valid", since: "effective" more accurately reflects the idea of effectiveness *erga*

omnes; and "valid" is not universally understood in the same way.

"described"

75. The term "described" is intended to establish a standard lower than that which would be established by the term "specified". Under this standard, a generic description of the receivable, without any specification of the identity of the debtor or the amount of the receivable, would be sufficient (e.g. "all my receivables from my car business").

"individually"/"in any other manner"

76. These words are intended to ensure that an assignment of existing and future receivables is effective, whether the receivables are described one by one or in any other manner that is sufficient to relate the receivables to the assignment.

Paragraph (2)

77. With a view to expediting the lending process and reducing the cost of the transaction, paragraph (2), in effect, provides that a master agreement is sufficient to transfer rights in a pool of future receivables. If a new document were to be required each time a new receivable would arise, the costs of administering a lending programme would increase considerably and the time needed to obtain properly executed documents and to review those documents would slow down the lending process to the detriment of the assignor.

78. Under paragraph (2), which provides that the master agreement is sufficient to transfer a pool of future receivables, and draft article 9, which provides that a future receivable is transferred at the time of the conclusion of the contract of assignment, rights in future receivables are transferred directly to the assignee without passing through the estate of the assignor. However, the question whether the assignment is effective as against the assignor's creditors or the insolvency administrator is a matter to be settled in accordance with the law governing priority under draft articles 24 to 26.

Article 9. *Time of assignment*

References:

A/CN.9/420, paras. 51 and 57
A/CN.9/432, paras. 109-112 and 254-258
A/CN.9/434, paras. 107 and 108 and 115-121
A/CN.9/445, paras. 221-226
A/CN.9/456, paras. 76-78 and 98-103

Commentary

79. Draft article 9 is intended: to recognize the right of the assignor and the assignee to agree on the time at which a receivable is transferred, as long as their agreement does not negatively affect the rights of third parties; to set a default rule that, in the absence of contrary agreement between the assignor and the assignee, the time at which a receivable is transferred is the time of the conclusion of the contract of assignment; and to clarify the meaning of other relevant provisions, such as draft articles 6, 8, 19 and 24 to 26.

80. Draft article 9 recognizes and, at the same time, limits party autonomy. The time specified by the assignor and the assignee binds third parties, a matter that may not be sufficiently clear in draft article 6. However, for such an agreement to be binding on third parties, it has to set a time of transfer which is not earlier than the time of the conclusion of the contract of assignment. This approach is in line with the principle, enshrined in draft article 6, since an agreement setting an earlier time could affect the order of priority between several claimants.

81. In the absence of an agreement between the assignor and the assignee setting the time of transfer of rights in the assigned receivables, the time of such transfer is the time of the conclusion of the contract of assignment, which is a fact that cannot be changed. While this approach is obvious with regard to receivables existing at the time they are assigned, a legal fiction is created with regard to future receivables (i.e. receivables arising from contracts not in existence at the time of the assignment). In practice, the assignee would acquire rights in future receivables only if they would in fact be created, but, in legal terms, the time of transfer would go back to the time of the conclusion of the contract of assignment. Such an approach is intended to facilitate the mobilization of future receivables by the assignor for the purpose of obtaining lower-cost credit or related services.

82. While draft article 9 sets the time of transfer of a receivable, it is not intended to set forth a priority rule, stating that an assignment is effective as against third parties as of the time it is made, since such a rule would be inconsistent with draft articles 24 to 26. If future receivables were transferred effectively as against third parties as of the time they were assigned, they would be removed from the insolvency estate or become subject to a security right irrespective of any publicity act required by the law governing priority.

Article 10. *Contractual limitations on assignments*

References:

A/CN.9/420, paras. 61-68
A/CN.9/432, paras. 113-126
A/CN.9/434, paras. 128-137
A/CN.9/445, paras. 49-51 and 227-231
A/CN.9/447, paras. 148-152
A/CN.9/455, paras. 47-51
A/CN.9/456, paras. 104-116

Commentary

83. The main objective of draft article 10 is to validate assignments made despite the existence of an anti-assignment clause in the original contract, in the assignment contract or in any subsequent assignment contract. The underlying policy is that it is more beneficial for everyone to facilitate the assignment of receivables and to reduce the transaction cost rather than to ensure that the debtor would

not have to pay a person other than the original creditor (assignor). Anti-assignment clauses may either defeat the purpose of a financing or service-related transaction altogether since they may invalidate assignments, or, at least, raise the cost of a transaction to the extent that financiers would need to check a potentially large number of contracts in order to ensure that no anti-assignment clauses are contained therein. In its considerations, the Working Group took into account that small debtors, such as consumers, would not be adversely affected by such a rule, since normally they do not have the bargaining power to insert anti-assignment clauses in their contracts and, in any case, they would often continue paying to the same bank account or post-office box, the control of which would switch from the assignor to the assignee without the debtors' knowledge. The Working Group also considered that, in any case, draft article 10 would not affect the interests of consumer-debtors to the extent that they were addressed by statutory limitations contained in consumer-protection law, since draft article 10 did not deal with statutory limitations. With regard to large debtors, the Working Group considered that they would not be adversely affected by the rule contained in draft article 10, since they have sufficient bargaining power and could take care of their own interests. The Working Group also thought that draft article 10 established an appropriate rule by not allowing such large debtors to preclude small- and medium-size enterprises from obtaining lower-cost credit or services on the basis of their receivables. Draft article 12 introduces an exception with regard to sovereign debtors (see paras. 94-96; for possible additional exceptions, see A/CN.9/WG.II/WP.104, remarks 3-7 to draft article 4).

84. Draft article 10 is thus intended to give the assignee a priority position as against the assignor's creditors in the case of default by the assignor and to enable the assignee to collect directly from the debtor, without, however, depriving the debtor of its rights and defences or of any cause of action the debtor may have against the assignor for breach of contract or even against the assignee based on tort. This approach constitutes a compromise between legal systems which invalidate assignments made in violation of anti-assignment clauses and legal systems which invalidate anti-assignment clauses. It thus attempts to counterbalance the need to preserve party autonomy and the need to facilitate financing and service-related transactions in the interest of trade in general. The Working Group recognized that invalidating anti-assignment clauses would preserve the interests of the assignee more effectively in that the assignee would be protected from the risk of accruing any liability and from the risk that the original contract might be declared avoided by the debtor for breach of an anti-assignment clause. However, it was widely felt that an approach based on the invalidation of anti-assignment clauses would excessively interfere with party autonomy and tilt the balance of interests in favour of the assignee to an inappropriate degree. On other hand, in an effort to make a step further in the direction of the protection of the debtor, the Working Group considered also the possibility of allowing the debtor to continue making payments in accordance with the original contract. Such an approach would allow the assignee to prevail in a conflict of priority with creditors of the assignor, but would deprive the assignee of the right to demand payment from the debtor. The Working Group noted that, under article 16 of the International Factoring Customs promulgated by Factors Chain International, in the case of an anti-assignment clause, the assignor is allowed to receive payments as an agent of the assignee. While recognizing that such a rule could be acceptable within groups of institutions subscribing to the same code of conduct, the Working Group decided not to extend its application to other practices, since depriving the assignee of the right to claim payment from the debtor would increase the risk of non-payment and thus the cost of credit.

85. Any contractual liability the assignor may have as against the debtor, under law applicable outside the draft Convention, for making an assignment in violation of an anti-assignment clause is not interfered with. By definition, the assignee cannot have contractual liability for breach of a contract to which the assignee is not a party. Any tortious liability that the assignee may have as against the debtor, under other law, is not interfered with either. In this context, the Working Group agreed that it should sanction malicious behaviour on the part of the assignee and that mere knowledge of the existence of an anti-assignment clause should not be sufficient to establish the assignee's liability. Penalizing the assignee for accepting an assignment while having knowledge of the anti-assignment clause would inadvertently result in encouraging the assignee to avoid a due-diligence test. If the assignee were diligent, it would find out about the anti-assignment clause and would not accept the receivables or would accept them at a substantially reduced value in view of the high risk of non-payment (for a secretariat suggestion as to ways in which this idea could be expressly stated in draft article 10, see A/CN.9/WG.II/WP.104, remarks 2-3 to draft article 10).

86. Draft article 10 is supplemented by a legal regime introducing sufficiently high standards for the debtor protection in the draft Convention. Other than having to pay the assignee (in the country and currency stipulated in the original contract), the legal position of the debtor is not affected by the draft Convention (draft article 17). Notification of the assignment may cut off only those rights of set-off of the debtor that arise from contracts other than the original contract. This result would be acceptable, since the debtor would be aware of this consequence of a notification and may plan accordingly. For example, the debtor may avoid incurring further obligations. In exceptional situations, in which, for example, an assignment in violation of an anti-assignment clause is a fundamental breach of the original contract, the debtor may even declare the original contract avoided. Such avoidance of the contract, however, which would deprive the assignee of the right to demand payment from the debtor, should be available only in exceptional circumstances. Otherwise, the risk of the contract being avoided might in itself have a negative impact on the cost of credit. In such situations, the debtor would be able to recover payments from the assignor but not from the assignee (draft article 23). This result is appropriate since, even in the absence of an assignment, the debtor would bear the risk of insolvency of its contractual partner. Furthermore, any goods returned by the debtor subsequent to the avoidance of the original contract would go to the assignee who would have offered value to the assignor in return for the receivables which were cancelled. On the

basis of the understanding that the draft Convention introduced a legal regime with sufficiently high debtor-protection standards, the Working Group decided that no reservation should be allowed to be made by States with regard to draft article 10 (for an exception with regard to sovereign debtors, see a secretariat suggestion with regard to draft article 12 in A/CN.9/WG.II/WP.104, remarks to draft article 12). In reaching this conclusion, the Working Group took into account that States considering the adoption of the draft Convention would need to weigh the potential inconvenience to the debtor of having to pay a different person against the advantage of increased availability of lower-cost credit to debtors and assignors, which could stimulate the economy at large.

87. Draft article 10 applies to any contractual clauses limiting the assignment in any way (and not only to clauses prohibiting assignment) but does not apply to statutory limitations to assignment or to limitations relating to the assignment of rights other than receivables (e.g. confidentiality clauses). As to statutory limitations, the Working Group considered the possibility of addressing them by validating the assignment, while allowing the debtor to discharge by paying in accordance with the original contract. Such an approach would allow the assignee to prevail over other creditors of the assignor in the case of assignor-default, while protecting the interests of the debtor. However, the Working Group was unable to reach agreement, since it could not find a way to distinguish between statutory limitations aimed at protecting the debtor (e.g. prohibiting the assignment of receivables owed by sovereign debtors) and statutory limitations aimed at protecting the assignor (e.g. prohibiting the assignment of wages).

88. The draft Convention, however, has already set aside statutory limitations to assignment to the extent that they refer to future receivables or to bulk assignments. Thus, the Working Group may wish to ensure, for example, that draft article 8 does not refer to future wages. In addition, the Working Group may wish to consider a limited rule dealing with statutory limitations aimed at protecting the debtor. Such a rule could, for example, validate an assignment as between the assignor and the assignee and as against third parties, but not as against the debtor. Moreover, the Working Group may wish to consider introducing the same rule for assignments of single receivables (which would normally be large-value receivables), in which a due-diligence test might not risk to increase the cost of credit. Such an approach might address the need to make, for example, assignments in loan syndications and participations subject to the consent of the debtor (for an analysis of possible approaches with regard to such practices, see A/CN.9/WG.II/WP.104, remarks 3-7 to draft article 4 and remark 1 to draft article 10).

Article 11. *Transfer of security rights*

References:

A/CN.9/420, paras. 69-74
A/CN.9/432, paras. 127-130
A/CN.9/434, paras. 138-147
A/CN.9/445, paras. 232-235
A/CN.9/456, paras. 117-126

Commentary

89. Draft article 11 reflects the generally accepted principle that accessory security rights are transferred automatically with the receivables which they secure. The question of the accessory or independent character of the security right and the substantive or procedural requirements to be met for the creation of such a security right are left to the law governing that right. Draft article 11 does not attempt to specify the law applicable to security rights, in view of the wide range of rights it is intended to cover (including, e.g. guarantees, pledges and mortgages) and of the wide divergences existing among the various legal systems in this regard.

90. The provision also recognizes the right of the assignor and the assignee to agree that an accessory right is not transferred to the assignee and is thus extinguished. Such an agreement may reflect the lack of willingness on the part of the assignee to accept the responsibility and the cost involved in the maintenance and safekeeping of collateral (e.g. taxation and insurance costs in the case of real estate or storage and insurance costs in the case of equipment). Draft article 11 also creates an obligation for the assignor to transfer to the assignee any independent right securing payment of the assigned receivables as well as the proceeds of such a right. With regard to independent guarantees or stand-by letters of credit, this provision is based on the understanding that the right to demand payment from the guarantor/issuer is not a receivable. As a result, the rights of the guarantor/issuer are not affected by the assignment of the independent undertaking, while the assignee has a right in the proceeds, which is of particular importance in the case of insolvency of the assignor.

91. Paragraph (2) is intended to ensure that any anti-assignment clause agreed upon between the assignor and the debtor or other person granting a security right does not invalidate the assignment. Under paragraph (3), any liability that the assignor may have for breach of contract, under law applicable outside the draft Convention, is not affected but is not extended to the assignee (this approach is consistent with the approach taken in draft article 10). The underlying policy is that security rights should be treated with regard to anti-assignment clauses in the same way as receivables, since often the value relied upon by the assignee lies in the security right and not in the receivable itself. For example, in securitization in which receivables are assigned from the original creditor to a special purpose vehicle ("SPV") fully owned by the original creditor, the value relied upon by investors buying securities issued by the SPV and backed by the receivables might be in the guarantee of the assignor. However, in the case of sovereign third-party guarantors, in line with draft article 12, the anti-assignment clause renders the assignment ineffective but only as against the sovereign third-party guarantor.

92. Whether or not the transfer of a security right is prohibited by agreement, if the transfer involves transfer of possession of the collateral and such transfer causes damage to the debtor or the person granting the right, any liability that may exist under law applicable outside the draft Convention is not affected. Paragraph (4) envisages, for example, a transfer of pledged shares which might em-

power a foreign assignee to exercise the rights of a shareholder to the detriment of the debtor or any other person who might have pledged the shares.

93. Under paragraph (5), the requirements of the law applicable outside the draft Convention to the form of transfer of security rights are not affected. As a result, a notarized document and registration may be necessary for the effective transfer of a mortgage, while delivery of possession or registration may be required for the transfer of a pledge. The draft Convention is not intended to affect either any requirements as to the form of an assignment of receivables secured by a certain asset (e.g. registration of an assignment secured by real estate). However, if the Working Group includes a rule on the form of assignment, subjecting the form of the assignment to the law of the assignor's location (see secretariat suggestion in A/CN.9/WG.II/WP.104, remarks to chapter III), that rule would need to be aligned with paragraph (5) (e.g. by providing that the law of the assignor's location would govern form, unless the receivables are backed by a security right in which case the law governing that right would govern form).

Article 12. *Limitations relating to Governments and other public entities*

References:

A/CN.9/432, para. 117
A/CN.9/455, para. 48
A/CN.9/456, paras. 115 and 116

Commentary

94. Draft article 12 is intended to ensure that sovereign debtors are not affected by assignments made in violation of anti-assignment clauses contained in public procurement or other similar contracts. The Working Group decided to take this approach so as not to reduce the acceptability of the draft Convention to States that may not be able to protect their interests by way of a statutory limitation.

95. As a result of draft article 12, an assignment of receivables owed by a sovereign debtor is not effective as against the sovereign debtor who can continue paying in accordance with the original contract. In addition, the defences and rights of set-off of the sovereign debtor are not affected, whether they arise from the original contract or any other contract. However, the assignment remains effective as against the assignor and the assignor's creditors, which is of particular importance in the case of the insolvency of the assignor.

96. The exact scope of draft article 12, namely whether it is going to apply to assignments of receivables arising from contracts concluded by the central Government, the local authorities, publicly owned commercial entities or governmental authorities acting in a commercial capacity, remains to be determined by the Working Group (on this matter, as well as on the question of turning draft article 12 into a reservation, see the secretariat's suggestions in A/CN.9/WG.II/WP.104, remarks to draft article 12).

D. Working paper submitted to the Working Group on International Contract Practices at its thirty-first session: Commentary to the draft Convention on Assignment in Receivables Financing (Part II): note by the secretariat

(A/CN.9/WG.II/WP.106) [Original: English]

CONTENTS

INTRODUCTION

This document contains the second part of the commentary to the draft Convention on Assignment in Receivables Financing (the title of the draft Convention has not been adopted yet by the Working Group; see A/CN.9/WG.II/WP.104, remarks to the title and the preamble). The second part of the commentary begins where the first part ended, i.e. with draft article 13, and goes up to draft article 31 (the first part of the commentary is contained in document A/CN.9/WG.II/WP.105). The commentary on the final provisions and the annex, if retained (see A/CN.9/WG.II/WP.104, remarks to the annex), will be prepared after the adoption of the draft Convention as a whole by the Working Group.

CHAPTER IV. RIGHTS, OBLIGATIONS AND DEFENCES

Section I. Assignor and assignee

Commentary

1. Unlike the other provisions of the draft Convention which deal with assignment as a transfer of property rights in receivables, the provisions contained in this section deal with issues that are normally addressed in the contract of assignment or other agreement between the assignor and the assignee. The usefulness of these provisions lies in the fact that they recognize party autonomy and allocate risks in the absence of an agreement between the assignor and the assignee.

Article 13. *Rights and obligations of the assignor and the assignee*

References:

A/CN.9/432, paras. 131-144
A/CN.9/434, paras. 148-151
A/CN.9/447, paras. 17-24
A/CN.9/456, paras. 127 and 128

Commentary

2. The primary purpose of draft article 13 is to restate in the context of the relationship between the assignor and the assignee the principle of party autonomy, a principle already enshrined in general terms in draft article 6. The assignor and the assignee are free to structure their mutual rights and obligations so as to meet their particular needs. They are also free to incorporate into their agreement any rules or conditions by referring to them in a general manner, rather than reproducing them in their agreement. The conditions under which the parties may exercise their freedom and the relevant legal consequences are left to the law governing their agreement.

3. Inspired by article 9 of the United Nations Convention on Contracts for the International Sales of Goods (hereinafter referred to as "the United Nations Sales Convention"), draft article 13 also states in paragraphs (2) and (3) a principle that may not be recognized in all legal systems, namely that, in the interpretation of assignment contracts, trade usages and practices must be taken into account. Paragraph (2) draws a clear distinction between trade usages and practices to the extent that the former need to be agreed upon so as to bind the parties, while the latter are binding without a specific agreement unless parties agree not to be bound. Such usages and practices produce rights and obligations for the assignor and the assignee. They cannot bind, however, third parties, such as the debtor or creditors of the assignor. They cannot bind subsequent assignors or assignees either. All those parties would not be necessarily aware of usages and practices agreed upon by the initial assignor and the initial assignee.

4. In view of the fact that paragraph (1) recognizes party autonomy, parties would always have the right to agree otherwise as to the binding nature of practices established between themselves. The words "unless otherwise agreed", contained in paragraph (2), may, therefore, not be necessary. These words, which do not appear in article 9 (1) of the United Nations Sales Convention, had been initially included in paragraph (2), since, as opposed to the hierarchy of legal rules established in the United Nations Sales

Convention, the draft Convention prevails over the parties' agreement. After the limitation of paragraph (1) to the mutual rights and obligations of the assignor and the assignee, the rule about the prevalence of the draft Convention has been deleted and the reason for deviating from the wording of article 9 (1) of the United Nations Sales Convention has been eliminated.

5. Paragraph (3) defines the scope of the matters covered by an international usage. Under paragraph (3), international usages bind only the parties to international assignments. Such a limitation was not thought to be necessary in article 9 since the United Nations Sales Convention applies only to international sales. It was thought, however, to be necessary in draft article 13 in view of the fact that the draft Convention may apply to domestic assignments of international receivables. In addition, under paragraph (3), as under article 9 (2) of the United Nations Sales Convention, usages are applicable only to the relevant practice. This means that an international factoring usage cannot apply to an assignment in a securitization transaction. However, unlike draft article 9 (2) of the United Nations Sales Convention, paragraph (3) does not refer to the subjective, actual or constructive, knowledge of the parties but only to the objective requirements that the usages must be widely known and regularly observed. The Working Group felt 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.

Article 14. *Representations of the assignor*

References:

A/CN.9/420, paras. 80-88
A/CN.9/432, paras. 145-158
A/CN.9/434, paras. 152-161
A/CN.9/447, paras. 25-40
A/CN.9/456, paras. 129 and 130

Commentary

6. Representations undertaken by the assignor are intended to reduce the risk involved in a transaction as to whether the assignee will be able to collect the receivables from the debtor, if necessary (in an assignment by way of security, the assignee does not need to collect unless the assignor defaults and in securitization or undisclosed invoice discounting the assignor continues to collect from the debtor as an agent of the assignee). As a result, representations constitute a significant factor for the assignee to determine the amount of credit to be made available to the assignor and the cost of credit.

7. In view of their importance for the pricing of a transaction, representations are highly negotiated and explicitly settled between the assignor and the assignee. Recognizing this reality, draft article 14 enshrines the principle of party autonomy with regard to representations of the assignor. Such representations may stem from the financing contract, the contract of assignment (if it is a separate contract), or from any other contract between the assignor and the assignee. In accordance with draft article 13 (2) and (3), they may also stem from trade usages and practices.

8. In addition to recognizing the principle of party autonomy, draft article 14 is intended to set forth a default rule allocating risks between the assignor and the assignee in the absence of an agreement of the parties as to this matter. In the allocation of risks, the overall aim of draft article 14 is to counterbalance the need for fairness and the need to facilitate increased access to lower-cost credit. Fairness is served to the extent that draft article 14 reflects a balance often established by the agreement of the parties. Normally, in financing agreements the assignor guarantees the existence of the assigned receivable but not the solvency of the assignor. On the other hand, increased access to lower-cost credit is served in so far as, if the parties have not agreed on representations, in the absence of a rule along the lines of draft article 14, the risk of non-payment would be higher. This situation could defeat a transaction (if the risk is too high) or, at least, reduce the amount of credit offered and raise the cost of credit. To the extent that the assignor is able to pass the cost to the debtor, the assignor's goods or services would be more expensive or even inaccessible to the debtor.

9. Under paragraph (1), the assignor represents that it has the right to assign the receivable, it has not assigned it already and that the debtor does and will not have any defences. In view of the need for the assignee to be able to estimate the risk involved in a transaction before extending credit, paragraph (1) provides that the representations have to be made, and take effect, at the time of the conclusion of the contract of assignment. Such representations are considered as being given not only to the immediate assignee but also to any subsequent assignee. As a result, any subsequent assignee may turn against the assignor for breach of representations. If representations were considered as being undertaken only as against the immediate assignee, any subsequent assignee would have recourse only against its immediate assignor, a process that would increase the risk and thus the cost of transactions involving subsequent assignments.

10. Subparagraphs *(a)* to *(c)* introduce representations that could be broadly described as representations relating to "the existence" of the receivable (or its assignability). If the assignor does not have the power to assign, has already assigned, or has deprived the receivables of any value by improperly performing the contract with the debtor, the receivable does not "exist". In this regard, during the deliberations of the Working Group, the concern was expressed that, by allowing the parties to modify representations relating to the very existence of the assigned receivables, draft article 14 might run counter to good faith standards. In order to address that concern, the suggestion was made that draft article 14 should be deleted altogether, or should not be subject to party autonomy or, at least, should be made subject to modification only by way of an explicit agreement of the parties. However, the Working Group agreed to retain draft article 14 unchanged. It was widely felt that, while making business practice conform to good

faith standards is an important goal, this should not be at the expense of the parties' ability to agree on risk- and thus cost-allocation in financing transactions. As a result, it was agreed that party autonomy should not be restricted, while contract interpretation in the case of an implicit agreement should be left to the law governing the contract.

11. The assignor is in violation of the representation as to its right to assign, introduced in subparagraph *(a)*, if the assignor does not have the capacity or the authority to act, or if there is any statutory limitation on assignment. This approach is justified by the fact that the assignor is in a better position to know whether the assignor has the right to assign. However, the assignor is not liable for breach of representations if the original contract contains an anti-assignment clause. The Working Group decided that no explicit reference to that rule was necessary in subparagraph *(a)*, since it is implicit in draft article 10, under which the assignment is effective even if it is in breach of an anti-assignment clause.

12. The representation, contained in subparagraph *(b)*, that the assignor has not already assigned the receivable is aimed at holding the assignor accountable to the assignee if, as a result of a previous assignment by the assignor, the assignee does not have priority. This result may occur if the assignee has no objective way to determine whether a previous assignment has occurred. Subparagraph *(b)*, however, does not require the assignor to represent that it will not assign the receivables to another assignee after the first assignment. Such a representation would run counter to modern financing practice in which the right of the assignor to offer to different lenders parts of the same receivables as security for obtaining credit is absolutely essential. Such negative-pledge type of representation is normally part of certain exceptional transactions, such as subordination agreements by way of which claimants of the same receivables settle conflicts of priority.

13. Subparagraph *(c)* places on the assignor the risk of hidden defences or rights of set-off of the debtor that may defeat in whole or in part the assignee's claim. This provision is premised on the fact that, by performing its contract with the debtor properly, the assignor will be able to preclude such defences from arising. In particular in the context of the sale of goods in which service and maintenance elements are included, such an approach would result in a greater degree of accountability of the assignor for performing properly its contract with the debtor. The provision is also based on the assumption that, in any case, the assignor will be in a better position to know whether the contract will be properly performed, even if the assignor is just the seller of goods manufactured by a third person. In all those cases, there is no need that the assignor has actual knowledge of any defences.

14. Subparagraph *(c)* has a wide scope, encompassing defences and rights of set-off whether they have a contractual or non-contractual source and whether they relate to existing or to future receivables. It also covers rights of set-off arising from contracts unrelated to the original contract. With regard to representations relating to the absence of defences against future receivables assigned in bulk by way of security, the Working Group thought that the representation contained in subparagraph *(c)* properly reflects current practice. According to such practice, in bulk assignments of defence-free and defence-ridden receivables assignors normally receive credit only in the amount of those receivables that are not likely to be subject to defences, while they have to repay a higher amount. In addition, in the case of non-payment by the debtor, the assignor has to take back the receivables for which the assignee is not able to obtain payment from the debtor and replace them with other receivables or to pay back the price of the unpaid receivables ("recourse financing").

15. The legal consequences of a breach of representations by the assignor are left to law applicable outside the draft Convention. The Working Group considered, in particular, the question whether, in the case of breach of representations by the assignor, the receivables are automatically retransferred to the assignor or whether, in such a case, an act of retransfer is necessary. The practical importance of this question lies in the fact that, if the receivables that the assignee is not able to collect are automatically retransferred and the assignor has in the meantime become insolvent, the assignee may have a better chance of separating the price paid for the receivables from the insolvency estate or, at least, of being paid from the proceeds of the receivables before unsecured creditors. If, on the other hand, an act of transfer is needed and the assignor has become insolvent, the retransfer will not be accepted by the insolvency administrator. The Working Group decided not to deal with the legal consequences of a breach of representations, holding that this matter involves a breach of the financing contract or the contract of assignment (if it is a different contract) and should be left to the law governing that contract. Reasons cited by the Working Group in support of this approach include that: matters relating to the underlying financing contract are beyond the scope of the draft Convention; and, in any case, it would be very difficult for the Working Group to reach agreement on issues such as liability for breach of representations.

16. Paragraph (2) reflects the generally accepted principle that the assignor does not guarantee the solvency of the debtor. As a result, the risk of debtor-default is on the assignee, a fact that the assignee takes into account in determining whether to extend credit and on what conditions. Recognizing the right of the parties to financing transactions to agree on a different risk-allocation, with a view to pricing the transaction in a different way, paragraph (2) allows the assignor and the assignee to agree otherwise. Paragraph (2) also provides that such an agreement may be implicit or explicit. The question of what constitutes an implicit agreement is left to the contract interpretation rules of the law governing the contract.

Article 15. *Right to notify the debtor*

References:

A/CN.9/420, paras. 89-94 and 119-122
A/CN.9/432, paras. 159-164 and 175
A/CN.9/434, paras. 162-165
A/CN.9/447, paras. 41-47
A/CN.9/456, paras. 131-144 and 193

Commentary

17. Draft article 15 deals with the question of who as between the assignor and the assignee has the right to notify the debtor and to request payment. It is not intended to address the conditions for a notification to be effective as against the debtor, which is dealt with in draft article 18, or the question of whom the debtor has to pay in order to obtain a valid discharge, which is dealt with in draft article 19, or other legal consequences of notification, dealt with in draft articles 20 and 22 (as to those matters, see para. 33).

18. The main objective of draft article 15 is to recognize the right of the assignee to notify the debtor and to request payment, without the cooperation or the authorization of the assignor. The Working Group recognized that, in some practices, it is normal for the assignor to notify the debtor at the time an assignment is made and to request that payment be made to the assignee (e.g. in factoring). At the same time, however, the Working Group was mindful of the fact that, in other practices, it was important for the assignee to be able to notify independently of the assignor, whether in the event of default or not. It was widely felt that, as a matter of principle, the assignee as the new creditor should have, as against the assignor, the right to notify the debtor and to request payment. The protection of the debtor against the risk of being notified and being asked to pay a potentially unknown person was thought to be a different matter which could be addressed by allowing the debtor in the case of notification by the assignee to request adequate proof (see paras. 47).

19. Granting the assignee an autonomous right to notify the debtor was considered to be practically important, in particular since the assignor might be unwilling or, in the case of insolvency, unable to cooperate with the assignee. Furthermore, it was thought that, at least in those legal systems in which priority was determined on the basis of the time of notification of the debtor, the assignor, acting in collusion with one claimant against the interests of another claimant, could determine the order of priority, unless each claimant had the right to notify the debtor independently of the assignor. The Working Group confirmed that the assignor may always notify the debtor independently of any assignee, even if such notification would constitute a breach of an agreement between the assignor and the assignee. It was widely felt that the debtor should be able to discharge its obligation as directed by the assignor in the notification and should not concern itself with the private arrangements existing between the assignor and the assignee (however, after notification of the assignment, the debtor is discharged by paying the assignee or as instructed by the assignee; see change to draft article 19 (2) suggested by the secretariat in A/CN.9/WG.II/WP.104, remark 8 to draft article 19).

20. With a view to accommodating non-notification practices, notification is formulated in paragraph (1) as a right and not as an obligation. In such practices, normally the debtor is not notified of the assignment and the assignor receives payment on behalf of the assignee. Draft article 15 is also intended to recognize practices in which the debtor keeps paying as before the assignment, while the assignor and the assignee agree on the control of the account or address (e.g. a post office box) to which payment is made. In those practices, in order to avoid any inconvenience to the debtor that might result in an interruption to the normal flow of payments, the debtor is either not notified at all or is notified and instructed to continue paying the assignor (such a notification is normally intended to preclude the debtor from acquiring rights of set-off after notification from contracts unrelated to the original contract). Only in exceptional situations (e.g. in the case of default), the debtor is notified and given different payment instructions (i.e. to pay the assignee or another person or to a different account or address).

21. While draft article 15 grants the assignee an autonomous right to notify the debtor and to request payment, it also recognizes the right of the assignor and the assignee to negotiate and agree on the matter of notification of the debtor so as to meet their particular needs. For example, the assignor and the assignee may agree that no notification would be given to the debtor as long as the flow of payments is not interrupted (as, e.g. in undisclosed invoice discounting). In order to ensure that there is no need for a specific agreement, the opening words of paragraph (1) are formulated in a negative way (“unless otherwise agreed”).

22. The definition of “notification” contained in draft article 5 does not include any reference to the identification of the payee and draft article 15 makes separate reference to notification and request of payment. This approach is intended to recognize the difference, both in purpose and in time, between a notification and a payment instruction and to validate practices in which notification is given without any payment instructions. Under this approach, a mere notification of an assignment is valid for the purpose of cutting off the debtor’s rights of set-off arising from contracts unrelated to the original contract, as well as for the purpose of changing the way in which the assignor and the debtor may amend the original contract. However, in order to avoid complicating the debtor’s discharge, the Working Group decided not to define “payment instruction” nor to base the debtor’s discharge on the receipt of a payment instruction. Under paragraph (1), a payment instruction may be sent either by the assignor with the notification or, subsequent to a notification, by the assignee. Paragraph (1), unlike draft article 19, refers to the time notification is “sent” (and not “received”), since neither the assignor nor the assignee has a way to assess the time of receipt. That matter may be important for the discharge of the debtor, dealt with in draft article 19, but not for the determination of who as between the assignor and the assignee has the right to give a payment instruction.

23. Paragraph (2) deals with the effectiveness of a notification given in breach of an agreement between the assignor and the assignee. The rule, introduced in the first sentence of paragraph (2), is that, if notification is given in violation of such an agreement and the debtor pays, the debtor is discharged (as this is a matter of the debtor’s discharge, the Working Group may wish to consider moving the first sentence of paragraph (2) to draft article 19; see A/CN.9/WG.II/WP.104, remarks to draft article 15). Whether the person violating such an agreement is liable for breach of contract, under law applicable outside the draft Convention, is a separate matter and should not affect the discharge of the debtor, who is not a party to that agree-

ment. A notification given in violation of an agreement between the assignor and the assignee, however, does not: cut off any rights of set-off of the debtor from contracts unrelated to the original contract (draft article 20); trigger a change in the way the assignor and the debtor may amend the original contract (draft article 22); or create a basis for the determination of priority under the law applicable to priority issues (draft articles 24-26). The Working Group thought that such results would give an undue advantage to the assignee who wrongfully notified the debtor. The negative formulation in paragraph (2) "is not ineffective" is intended to ensure that the mere violation of an agreement between the assignor and the assignee, on the one hand, does not invalidate the notification for the purpose of debtor-discharge, but, on the other hand, does not interfere with contract law as to the conditions required for such an agreement to be effective.

Article 16. *Right to payment*

References:

A/CN.9/447, paras. 48-68
A/CN.9/456, paras. 145-159

Commentary

24. Draft articles 2, 8 and 15 establish, as between the assignor and the assignee, the assignee's right to request payment. It is, therefore, subject to the general principle of party autonomy embodied in draft article 6 and is formulated as a default rule applicable in the absence of an agreement between the assignor and the assignee. It is also subject to the debtor-protection and the priority provisions of the draft Convention. While draft article 16 does not define proceeds, it is formulated in a broad way so as to encompass both proceeds of receivables and proceeds of proceeds, as well as payment both in cash and in kind, e.g. returned goods (for a suggestion to define "proceeds" and to refer to "payment or other discharge", see A/CN.9/WG.II/WP.104, remark 1 to draft article 16).

25. The assignee's right in proceeds is independent of any notification of the assignment. The reason for this approach is the need to ensure that: if payment is made to the assignee before notification, the assignee may retain the proceeds of payment; and if payment is made to the assignor after notification (which does not discharge the debtor's debt), the assignee would have a right in such payments. Such a right is of particular importance, if the assignor or the debtor becomes insolvent. If payment is made to the assignor after notification, in principle, the assignee could claim payment from the assignor, under draft article 16 (1) *(b)*, or from the debtor, under draft article 19 (2). In practice, however, the assignee would not claim a second payment from the debtor, unless the assignor has become insolvent. In such a case, any claim that the debtor might have against the estate of the insolvent assignor (e.g. on the basis of the principles of unjust enrichment) would normally be meaningless, since it is unlikely that claimants with personal claims would be able to obtain payment. However, this result is appropriate in that the debtor, who pays the assignor after notification, takes the risk of having to pay twice.

26. Draft article 16 covers the situations in which payment has been made to the assignee, the assignor or another person. In the latter case, the assignee's right is subject to priority. In this context, the Working Group decided not to make a broad reference to any "superior right under applicable law" which would encompass the right of a depositary institution in payments received in good faith. The Working Group thought that the assignee should not be able to claim from the depositary institution such payments received in good faith and commingled with other assets (for a suggestion to clarify in paragraph (2) that the right to claim payment from a third person is a right as between the assignor and the assignee which is subject to party autonomy, see A/CN.9/WG.II/WP.104, remark 2 to draft article 16).

27. Under paragraph (2), while the assignee may claim all the proceeds of payment, it may only retain an amount equal to the amount owed plus any interest (the assignor's right to interest may need to be addressed explicitly; see A/CN.9/WG.II/WP.104, remark 3 to draft article 16). This approach is intended to reflect normal practice in assignments by way of security, under which the assignee may have the right to collect the full amount of the receivable but has to account for and return to the assignor or its creditors any balance remaining after payment of the assignee's claim. The Working Group may wish to reconsider whether the expression "value of its right" adequately reflects the intent of paragraph (2).

28. As to the interplay between draft articles 12 and 16, it should be noted that the sovereign debtor could discharge its debt by paying the assignor, while the assignee would have a right to claim the proceeds of payment from the assignor. The question whether that right is a right in rem or ad personam is left to the law applicable to priority.

Section II. Debtor

Article 17. *Principle of debtor protection*

References:

A/CN.9/420, para. 101
A/CN.9/432, paras. 33-38, 89 and 90, 206 and 244
A/CN.9/434, paras. 86-95
A/CN.9/445, paras. 195-198
A/CN.9/456, paras. 21, 81 and 168-176

Commentary

29. The primary goal of any assignment-related law may be to strike an appropriate balance between, on the one hand, the need to allow parties to mobilize their receivables for the purpose of obtaining credit and services and, on the other hand, to ensure that the legal position of the debtor is not adversely affected. In order to highlight the importance of the need to protect the debtor in a prominent manner, the Working Group decided to include a reference in the preamble and a general statement of this principle of para-

mount importance for the draft Convention in draft article 17. The debtor-protection principle finds more specific application in the provisions of section II of chapter IV. It is also the reason for the requirement contained in draft article 1 (3) that, for the provisions of the draft Convention that affect the debtor's rights and obligations to apply (i.e. chapter III and section II of chapter IV), the debtor needs to be in a Contracting State. The same principle is the reason for the limitation of the right of the assignor and the assignee to opt out of the draft Convention as a whole (draft article 6). Such an opting out could set aside the debtor-protection system introduced by the draft Convention. The need to introduce a special protection for sovereign debtors is also the underlying policy in draft article 12. Draft article 28, subjecting a number of debtor-related issues to the law governing the receivable is also a special application of the general principle enshrined in draft article 17. This law will be the law governing the original contract, which is likely to be the law chosen by the assignor and the debtor at the time they undertook their original obligations.

30. The basic rule of paragraph (1) is that the draft Convention is not intended to adversely affect the debtor's rights and obligations. The draft Convention is, in particular, not designed to change the payment terms stipulated in the original contract (e.g. the amount owed, the time and the place of payment). There are three exceptions to this basic rule. First, the debtor may negotiate with the assignor or the assignee and agree to waive its defences or rights of set-off. Such an agreement may allow the debtor to obtain a benefit, such as a higher amount of credit, a longer repayment period or a lower interest rate. Draft article 21 deals with such an agreement between the assignor and the debtor and introduces certain limitations. It does not deal, however, with waivers of defences agreed upon by the assignee and the debtor, which are left to other law. Whether a waiver of defences is to be construed as a consent or confirmation of the debtor's consent to the assignment is also left to other law (see para. 56).

31. The second exception lies in those provisions of the draft Convention that do affect the debtor's legal position. Those provisions include: draft article 10 (an assignment is effective even if it is made despite the existence of an anti-assignment clause); draft article 19 (after notification, the debtor may discharge its obligation by paying as instructed in the notification or in a subsequent payment instruction given by the assignee); draft article 20 (2) (after notification, the debtor may not raise against the assignee any right of set-off arising from contracts unrelated to the original contract); draft article 20 (3) (the debtor may not raise against the assignee any claim for breach of an anti-assignment clause by the assignor); draft article 22 (after notification, the debtor's right to modify the original contract without the consent of the assignee is limited); and draft article 23 (the debtor cannot recover from the assignee any payments despite the fact that the assignor may have failed to perform; the debtor will have to recover such payments from the assignor and thus bear the risk of insolvency of its contractual partner).

32. The third exception to the rule established in paragraph (1) is contained in paragraph (2). Under paragraph (2), a payment instruction, whether given with the notification or subsequently, may change the person, address or account to which payment is to be made. However, a payment instruction may not change the currency of payment. It may not change the country of payment either, unless the change is beneficial to the debtor and results in payment being allowed in the country in which the debtor is located. Such a change of the country of payment is often allowed in factoring contracts with a view to facilitating payment by debtors.

Article 18. *Notification of the debtor*

References:

A/CN.9/420, paras. 124 and 125
A/CN.9/432, paras. 176 and 177 and 187
A/CN.9/434, paras. 172-175
A/CN.9/447, paras. 45-47 and 158 and 159
A/CN.9/455, paras. 59-66
A/CN.9/456, paras. 177-180

Commentary

33. As already mentioned (para. 17), the draft Convention deals with the various aspects of notification of assignment in several articles. Draft article 5 *(f)* defines notification for the purposes of the draft Convention. Draft article 15 deals with notification as a right of the assignor and the assignee. Draft article 18 addresses notification issues that are relevant to the legal position of the debtor in general. It also refers to a payment instruction, which, while not defined in the draft Convention, is generally described in draft article 17 (2). Draft articles 19, 20 and 22 deal with the legal consequences of notification.

34. The primary purpose of draft article 18 is to restate the "receipt rule", i.e. that a notification and a payment instruction become effective when received by the debtor. The main reason for the adoption of this rule by the Working Group is that a notification, whether accompanied by a payment instruction or not, has significant consequences for the legal position of the debtor (it triggers a change in the way in which the debtor may discharge its debt, it cuts off rights of set-off arising from contracts unrelated to the original contract and it changes the way in which the debtor may amend the original contract in agreement with the assignor). Such consequences may occur only when a notification or a payment instruction is in a language that is "reasonably expected to inform the debtor about its contents". For example, when the notification is in electronic form and is not readily readable, the debtor should be able to decode it easily. In order to avoid creating uncertainty, paragraph (1) introduces a " safe harbour" rule, according to which the language of the original contract meets the required standard.

35. Upon receipt of a notification, if the debtor is not prepared to accept any change that may result from an assignment, the debtor, knowing that it will not be able to accrue additional rights of set-off, may avoid to enter into further contractual relationships with the assignor. In ex-

ceptional cases, in which the assignment is a fundamental breach of an anti-assignment agreement, the debtor may even be able to avoid the original contract. However, such a radical remedy should be exercised only when an assignment results in extreme hardship to the debtor. Otherwise, the risk of the contract being avoided might in itself have a negative impact on the cost and the availability of credit (see para. 50; see also A/CN.9/WG.II/WP.105, para. 86). In order to avoid this result, the Working Group may wish to consider clarifying in draft article 10 that any relief available to the debtor against the assignor for breach of an anti-assignment clause would be limited to a claim for compensatory damages (or that the debtor may not declare the original contract avoided on the sole ground that the assignor violated an anti-assignment clause). This result could be obtained anyway, since draft articles 10, 20 (3) and 22 could be construed as precluding such a radical remedy, at least after notification of the assignment. Allowing the debtor to declare the contract avoided on the sole ground of the violation of an anti-assignment clause would run counter to the principle that the assignment is effective even if it is made in violation of an anti-assignment clause and to the principle that, in such a case, the debtor may not raise against the assignee any claim it might have against the assignor for breach of contract. In addition, if the minimum, i.e. a modification of the original contract, is not allowed after notification of the debtor without the consent of the assignee, the maximum, i.e. the cancellation of the contract, could not be allowed either.

36. Under paragraph (2), a notification may relate to future receivables. This rule is of paramount importance. If a notification or a payment instruction relating to future receivables could not be effectively given, the debtor could refuse to pay the assignee despite a notification or a payment instruction. Furthermore, if the law applicable to priority issues under draft articles 24 to 26 settles priority conflicts on the basis of the time of notification, assignees would not be able to effectively notify the debtor and thus to establish priority as to future receivables (see para. 78). Such a result could virtually defeat the availability of credit on the basis of future receivables.

37. The Working Group considered the question whether, in order to protect the assignor against the risk of being deprived of all its receivables, the effectiveness of a notification relating to future receivables should be limited to a fixed period of time, which could possibly be extended by way of a second notification. The Working Group decided not to introduce such a limitation. It was thought that such restrictions were a matter for the financing contract, with which the draft Convention should avoid any interference. It was also considered that any fixed time period would be arbitrary and disruptive of commercial practices based on long-term relationships. In particular in long-term contracts, a requirement for the renewal of a notification at the expiry of a fixed period could be overly burdensome both for the assignee and the debtor. The assignee would find it difficult to establish the date of receipt of the notification by the debtor, when the fixed time period would start running. The debtor would be overly burdened with the obligation to verify the date in the past when notification had been received in order to assess whether it could obtain a discharge by paying the assignee.

38. Paragraph (3) is one of the most important provisions of the draft Convention, in particular for international factoring transactions. In such transactions, the assignor normally assigns the receivables to an assignee in its own country (export factor) and the export factor subsequently assigns the receivables to an assignee in the debtor's country (import factor). Under such an arrangement, collection from the debtor is facilitated to the extent that the import factor is able to take all the necessary measures for the second assignment to be effective as against the debtor. The efficient operation of such transactions is based on the assumption that the first assignment is also effective as against the debtor. In view of the fact that the debtor is normally notified only of the second assignment, it is essential to ensure that that notification of the second assignment covers the first assignment as well. Otherwise, the first assignment might be rendered ineffective as against the debtor, a situation which might affect the effectiveness of the second assignment as well. In order to address situations in which more than one subsequent assignment is made, paragraph (3) provides that a notification covers any prior, and not only the immediately preceding, assignment (as to the issue of discharge of the debtor in the case of several notifications relating to subsequent assignments, see para. 45).

Article 19. *Debtor's discharge by payment*

References:

A/CN.9/420, paras. 98-117, 127-131, 169-173 and 179
A/CN.9/432, paras. 165-174 and 178-204
A/CN.9/434, paras. 176-191
A/CN.9/447, paras. 69-93 and 153-157
A/CN.9/455, paras. 52-58
A/CN.9/456, paras. 181-193

Commentary

39. Draft article 19 has a twin goal, to provide a clear mechanism for the discharge of the debtor's obligation by payment and to ensure payment of the debt. It is not intended to deal with the discharge of the debtor in general or with the payment obligation as such, since that obligation is subject to the original contract and to the law governing that contract. The basic rule is that, until the debtor receives notification of an assignment, it may be discharged by paying in accordance with the original contract, while, after notification, discharge is obtained only by payment in accordance with the instructions given by the assignor or by the assignee with the notification, or subsequently by the assignee. Draft article 19 deals also with a number of particular situations in which: several notifications are involved; the debtor is notified by the assignee and is in doubt as to whether the assignee is the rightful claimant; discharge by payment under law applicable outside the draft Convention; and discharge by payment in the case of an assignment that is null and void.

40. Under paragraph (1), until the time of receipt of a notification, the debtor is entitled, not obliged, to discharge by paying in accordance with the original contract (i.e. by paying the assignor or another person or to an account or

address indicated in the original contract). In view of the fact that the assignment is effective as of the time of the conclusion of the contract of assignment, the debtor, having knowledge of the assignment, may choose to discharge its debt by paying the assignee. However, in such a case the debtor takes the risk of having to pay twice, if it is later proven that no assignment took place. The Working Group decided not to refer explicitly to the possibility of the debtor being able to pay either the assignor or the assignee in order to avoid undermining practices, such as securitization, in which the debtor is normally expected to continue paying the assignor (however, the problem may not be resolved in this way; for the secretariat's suggestion in this regard, see A/CN.9/WG.II/WP.104, remark 1 to draft article 19). The reference to payment "in accordance with the original contract", rather than to payment to the assignor, is intended to preserve the right of the assignor and the debtor to agree to any type of payment suitable to meet their needs (e.g. payment to a bank account without identification of the account owner, or payment to a third person).

41. The Working Group considered at some length the question whether knowledge of an assignment should be treated as a notification and trigger a change in the way in which the debtor could discharge its obligation. It was argued that it would run counter to good faith to allow the debtor to discharge its debt by paying the assignor, in particular if the debtor had actual knowledge of the assignment, or by paying the assignee, in particular if the debtor knew that someone else had a superior right. The Working Group decided that knowledge of an assignment should not affect the discharge of the debtor. It was widely felt that, while making business practice conform to good faith standards is an important goal, this should not be at the expense of certainty. Certainty would be reduced if knowledge of the assignment were to trigger a change in the way in which the debtor could discharge its obligation. In such a case, the assignor or the person with a superior right, who would not be in control of the relevant evidence, would need to establish what the debtor knew. If the burden of proof were to be placed on the debtor, the debtor would not be able to obtain a valid discharge unless it was able to establish that it had no knowledge of the assignment. In such a case, it would need to be determined what constitutes knowledge (e.g. general knowledge of the fact that an assignment took place or knowledge of the details of the assignment, such as the exact amount of the receivables assigned and, in the case of an assignment by way of security, of the debt secured). This process would be particularly cumbersome in the case of several conflicting assignments. As a result, the certainty necessary in a debtor-discharge rule would be seriously compromised. The Working Group also took into account that in certain cases (e.g. in securitization and undisclosed invoice discounting) it is normal business practice for the debtor to continue paying the assignor even though the debtor knows of the assignment, since the assignee does not have the business structure necessary to receive payments.

42. The Working Group also considered the question whether the nullity (e.g. for fraud or duress or lack of capacity to act) or the knowledge of the nullity of an assignment should be taken into account in the debtor's discharge. At an early stage in its work, the Working Group considered a provision, according to which the debtor should be able to discharge its obligation even if any of the assignments in a chain of assignments was null and void (A/CN.9/WG.II/WP.96, draft article 27). It was thought that the debtor should not be exposed to the risk of having to pay twice merely because parties unknown to the debtor chose to engage in subsequent assignments. Ultimately, the Working Group decided that the issue of payment to a person the assignment to whom was null and void arose only in exceptional situations and could be left to law applicable outside the draft Convention (this is the thrust of draft article 19 (8); for the secretariat suggestions with regard to this matter, see A/CN.9/WG.II/WP.104, remarks 6-8 to draft article 19).

43. Unlike paragraph (1), paragraph (2) does not allow the debtor a choice as to how to discharge its debt. After notification, the debtor can only discharge its obligation by paying the assignee or as instructed by the assignee. The reference to payment instructions is intended to address the needs of various practices. The assignee may, for example, notify the debtor, so as to freeze the debtor's rights of set-off, without requesting payment or requesting the debtor to continue paying the assignor (this is the case, e.g. with undisclosed invoice discounting or securitization). The Working Group may wish to explicitly state in paragraph (2) what is already stated in draft article 15 (1), namely that such instructions may be given by the assignor or the assignee with the notification or only by the assignee subsequent to a notification (see A/CN.9/WG.II/WP.104, remark 8 to draft article 19).

44. Paragraphs (3) and (5) are intended to provide simple and clear discharge rules in the case of several notifications. Paragraph (3) deals with situations in which the debtor receives several notifications relating to more than one assignment of the same receivables by the same assignor ("duplicate assignments"). Such situations do not necessarily involve fraud. They may, for example, involve several assignments of different parts of the receivables by way of security, in which the main issue is who will obtain payment first (i.e. who has priority). Having agreed that the assignment should not adversely affect the legal position of the debtor, the Working Group drew a clear distinction between the issue of the debtor's discharge and the issue of priority. Thus, payment under paragraph (3) in accordance with the first notification discharges the debtor, even if the person receiving payment does not have priority. The underlying rationale is that it would be unfair and inconsistent with the policy of debtor protection to require the debtor to determine who among several claimants has priority and that the debtor pays a second time if it pays the wrong person. The debtor would most likely have a cause of action against that person, but the debtor's rights may be frustrated if that person becomes insolvent. The risk of insolvency of the debtor receiving payment should be on the various claimants of the receivables and not on the debtor. Such claimants would have to settle among themselves their rights in the proceeds of payment in accordance with the law governing priority under the draft Convention.

45. Paragraph (5) deals with notifications relating to more than one subsequent assignment. Such situations are rare in

practice, since normally only the last in a chain of assignees notifies the debtor and requests payment. In any case, in order to avoid any uncertainty as to how the debtor may discharge its debt, paragraph (5) provides that the debtor has to follow the instructions contained in the notification of the last assignment in a chain of assignments. For that rule to apply, the notifications received by the debtor have to be readily identifiable as notifications relating to subsequent assignments. Otherwise, the rule contained in paragraph (3) would apply and the debtor would be discharged by payment in accordance with the first notification received. In any case, under paragraph (6), the debtor, if in doubt, could request adequate proof from the assignees notifying (for a secretariat suggestion that, until such proof is offered, the debtor could discharge its debt by paying the assignor, see A/CN.9/WG.II/WP.104, remark 2 to draft article 19). If the debtor receives several notifications relating to several assignments of the same receivables by the same assignor and to subsequent assignments, under a combined application of paragraphs (3) and (5), the debtor is discharged by paying in accordance with the first notification of the last assignment.

46. Paragraph (4) is intended to ensure that the assignee may change or correct its payment instructions. Whether the debtor is notified by the assignor or the assignee, if a new payment instruction is sent with regard to one and the same assignment, the debtor may discharge its debt only in accordance with that instruction. The only condition is that, in line with the policy underlying draft article 15 (1), that payment instruction, which is given subsequent to the notification, has to be given by the assignee, who is the only person entitled to dispose of the receivables. In order to protect the debtor against the risk of having to pay twice, paragraph (4) expressly provides that a payment instruction received by the debtor after payment is to be disregarded.

47. Under draft article 15, notification may be given by the assignor or by the assignee independently of the assignor. As a result, the debtor receiving notification of the assignment from a possibly unknown person may be in doubt as to whether that person is a legitimate claimant, payment to whom would discharge the debtor. In order to protect the debtor from uncertainty as to how to discharge its debt in such cases, paragraph (6) gives the debtor a right to request the assignee to provide adequate proof of the assignment within a reasonable period of time. Paragraph (6) does not introduce an obligation of the debtor, since requesting additional proof in all cases would unnecessarily delay payment and add to the cost of the notification. The determination of what constitutes "adequate" proof and "reasonable" period of time is a matter of interpretation for the courts or arbitral tribunals taking into account the particular circumstances. The Working Group thought that the flexibility introduced with these terms was necessary, since no rule could be found which would be suitable for all possible cases. In addition, in order to avoid any uncertainty that might ensue as a result of the use of these terms, the Working Group decided to include a "safe harbour" rule, according to which a written confirmation from the assignor constitutes adequate proof.

48. The notification does not trigger the obligation to pay, which remains subject to the original contract and the law applicable thereto. This means that the debtor does not have to pay upon notification and does not owe interest for late payment while it awaits the adequate proof requested. If, however, the debt becomes payable within that period in accordance with the original contract, the question arises whether the payment obligation is suspended until the debtor receives such proof and has a reasonable time to assess it and act thereon. If the payment obligation is not suspended, the significance of the protection afforded to the debtor by paragraph (6) may be reduced to the extent that the debtor delaying payment, even for good reasons, would have to pay interest. The Working Group proceeded on the understanding that the payment obligation would be suspended in such cases, but chose not to include any explicit wording in paragraph (6), since that result could be reached without any explicit wording anyway and any additional wording could inadvertently interfere with national law on interest. The Working Group may wish to reconsider this approach. Any uncertainty as to this matter might reduce the usefulness of paragraph (6). It may be preferable to explicitly state that the payment obligation is suspended. In order to avoid suspension of payment which could disadvantage both the assignor and the assignee, the Working Group may wish to consider that, if the debt becomes payable during the period when the debtor awaits proof of the assignee from the assignee, the debtor should discharge its debt by paying the assignor (see A/CN.9/WG.II/WP.104, remark 2 to draft article 19).

49. Paragraph (7) is intended to ensure that draft article 19 does not exclude other ways of discharge of the debtor's obligation that may exist under national law applicable outside the draft Convention. However, paragraph (7) may inadvertently result in a debtor ignoring a notification given under the draft Convention (e.g. because it relates to future receivables, which may not be allowed under other law) and paying someone else in accordance with other law. For that reason, the Working Group may wish to consider validating payment under other law only if it is made to a legitimate assignee under the draft Convention, while limiting recourse to payment into court and the like to cases involving several notifications (see A/CN.9/WG.II/WP.104, remarks 3-5 to draft article 19) and, possibly, notification by the assignee. If such an approach were to be followed, paragraph (8) may not be necessary, since, if the debtor, being notified by the assignee, is in doubt as to the validity of an assignment, it could discharge its debt by paying into court.

Article 20. *Defences and rights of set-off of the debtor*

References:

A/CN.9/420, paras. 66-68 and 132-135
A/CN.9/432, paras. 205-209
A/CN.9/434, paras. 194-197
A/CN.9/447, paras. 94-102
A/CN.9/456, paras. 194-199

Commentary

50. Draft article 20 is another particular application of the general principle that the debtor's legal position should not

be unduly affected as a result of the assignment. The debtor has against the assignee all the defences and rights of set-off that the debtor could raise against the assignor. What those defences and rights of set-off are is a matter not addressed in the draft Convention but left to other law.

51. Under paragraph (1), the debtor may raise against the assignee all the defences that arise from the original contract, without any limitation, including: contractual claims, which, in some legal systems, might not be considered "defences"; rights for contract avoidance, e.g. for mistake, fraud or duress; exemption from liability for non-performance, e.g. because of an unforeseen impediment beyond the control of the parties; and counter-claims under the original contract. Such defences and rights of set-off may be raised irrespective of whether they are available at the time of notification of the assignment or become available only after such notification. The Working Group may wish to consider the question whether rights of set-off arising from contracts between the assignor and the debtor that are closely related to the original contract (e.g. a maintenance or other service agreement supporting the original sales contract) should be treated in the same way as rights of set-off arising from the original contract.

52. Paragraph (2) introduces a time limitation with regard to rights of set-off arising from any source other than the original contract, i.e. a separate contract between the assignor and the debtor, a rule of law (e.g. a tort rule) or a judicial or other decision. Such rights may not be raised against the assignee if they become available after notification of the assignment. The rationale underlying this rule is that the rights of a diligent assignee who notifies the debtor should not be made subject to rights of set-off arising at any time from separate dealings between the assignor and the debtor or other events, of which the assignee could not be reasonably expected to be aware. On the other hand, the interests of the debtor are not unduly affected, since, if the fact that the debtor cannot accumulate rights of set-off constitutes an unacceptable hardship for the debtor, the debtor can avoid entering into new dealings with the assignor (as to the question whether the debtor could declare the original contract avoided, see para. 35). In view of the above-mentioned rationale of paragraph (2), rights of set-off arising from separate contracts between the debtor and the assignee are not affected. Such rights can be asserted against the assignee even after notification of the assignment, like rights of set-off arising from the original contract. It should also be noted that a notification results in freezing the debtor's rights of set-off, whether it contains a payment instruction or not. This approach is intended to accommodate practices in which a bare notification is given for the purpose of exactly precluding the debtor from accruing rights of set-off from acts or omissions of the assignor that are beyond the assignee's control, while the debtor is expected to continue paying the assignor. As a result of draft article 12, according to which an assignment made despite an anti-assignment clause would be ineffective as against a sovereign debtor, draft article 20 would not affect the rights of a sovereign debtor.

53. The Working Group considered a suggestion to elaborate on the meaning of the term "available" by stating that a defence or right of set-off cannot be excluded if at the time of notification it is "actual and ascertained". That suggestion was not adopted since it would result in limiting inappropriately the rights of set-off available to the debtor to those that were quantified at the time of the notification. In order to avoid leaving the matter completely unresolved, the Working Group also considered various suggestions as to the law applicable to rights of set-off. Reference was made to the law governing the receivable and to the law of the assignor's location. The Working Group may wish to consider referring instead, at least with regard to contractual rights of set-off, to the law governing the contract from which the right of set-off might arise (see A/CN.9/WG.II/WP.104, remarks 1-2 to draft article 28).

54. Paragraph (3) is intended to ensure that the debtor may not raise against the assignee by way of defence or set-off the breach of an anti-assignment clause by the assignor. The debtor may have a cause of action against the assignor, if, under law applicable outside the draft Convention, the assignment constitutes a breach of contract which results in a loss to the debtor. However, the mere existence of an anti-assignment clause is not a violation of the representation contained in draft article 14 (1) *(a)*. In the absence of a provision along the lines of paragraph (3), draft article 10 (3), holding the assignee harmless for breach of contract by the assignor, could be deprived of any meaning.

Article 21. *Agreement not to raise defences or rights of set-off*

References:

A/CN.9/420, paras. 136-144
A/CN.9/432, paras. 218-238
A/CN.9/434, paras. 205-212
A/CN.9/447, paras. 103-121
A/CN.9/456, paras. 200-204

Commentary

55. In order to obtain more value for their receivables and at a lower cost, assignors normally guarantee as against assignees the absence of defences and rights of set-off by the debtor. Recognizing this practice, draft article 14 (1) *(c)* provides that such a guarantee exists even in the absence of an agreement between the parties in this regard. In practice, if such representations cannot be given and the receivables are likely to be subject to defences, such receivables are either not accepted by assignees, or are accepted at a significantly reduced value or are accepted only on a recourse basis (i.e. if the assignee cannot collect from the debtors, it has the right to return the receivables to and collect from the assignor). In order to avoid those adverse effects, assignors, as a matter of practice, negotiate with debtors waivers of the defences and rights of set-off that debtors may raise against any future assignee. On the basis of such waivers, assignees determine the credit terms offered to assignors, which in turn are likely to affect the credit terms assignors offer to debtors.

56. With a view to allowing assignors to obtain lower-cost credit, draft article 21 validates such waivers of defences and rights of set-off. Furthermore, in order to avoid uncertainty as to the legal consequences of a waiver and that a court may override it as being unfair to the debtor, paragraph (1) states what may appear obvious in some legal systems, namely that a waiver precludes the debtor from raising defences and rights of set-off against the assignee. In recognition of the fact that in practice a waiver may be agreed upon at the time of the conclusion of the original contract, as well as at an earlier or later time, paragraph (1) does not make specific reference to the point of time at which a waiver may be agreed upon. Paragraph (1) does not make explicit reference to the acceptance of an assignment by the debtor operating as a waiver or as a confirmation of a waiver either. The matter is left to other law. Paragraph (1) does not require either that the defences are known to the debtor or are explicitly stated in the agreement by which the defences are waived. The Working Group thought that such a requirement would introduce an element of uncertainty, since the assignee would need to establish what the debtor knew or could have known in each particular case.

57. While aimed at facilitating increased access to lower-cost credit, which is in the interest of trade in general, draft article 21 does not neglect the protection of the debtor. In order to protect debtors from undue pressure by creditors so as to waive their defences, paragraph (2) introduces reasonable limitations with respect to such waivers of defences. Such limitations refer to the form in which such waivers can be made, to certain types of debtors and to certain types of defences. In view of the fact that the scope of paragraph (1) is limited to waivers agreed upon by the assignor and the debtor, the limitations contained in paragraph (2) do not apply to waivers agreed upon by the debtor and the assignee. The Working Group thought that the draft Convention should not limit the debtor's ability to negotiate with the assignee in order to obtain a benefit, such as a lower interest rate or a longer payment period. At the same time, the Working Group also thought that, in view of the fact that agreements between assignees and debtors are outside the scope of the draft Convention, the draft Convention should not empower the debtor to negotiate waivers with assignees, if, under the law applicable, the debtor would not have such a power.

58. Paragraph (1) introduces further limitations. A waiver cannot be a unilateral act or an oral agreement; it has to take the form of a signed written agreement, so as to ensure that both parties are well informed about the fact of the waiver and its consequences, including the benefits offered to the debtor in return, and to facilitate evidence. In addition, a waiver cannot override the consumer-protection law prevailing in the country in which the debtor has its location (which in this context is to be understood as the place of business). In order to avoid terminological and other differences existing among the various legal systems, paragraph (1) refers to debtors in transactions for "personal, family or household purposes". Such reference is qualified by the term "primarily", so as to ensure that the limitation would apply only to transactions for purely consumer purposes (i.e. transactions between consumers) and not to transactions for both consumer and commercial purposes (i.e. transactions between a consumer and a business entity). The Working Group may wish to reconsider this approach. It would appear to be consistent with the purpose of protecting consumer debtors to apply this provision to a transaction serving consumer purposes with respect to one party and commercial purposes from the perspective of the other party (the same would be true in the context of draft article 23 but not in the context of draft article 4; see para. 70 and A/CN.9/WG.II/WP.105, para. 43).

59. Moreover, under paragraph (2), a waiver cannot relate to defences arising from fraudulent acts committed by the assignee. Such a result would run counter to basic good faith standards. With a view to protecting an assignee who accepts an assignment in good faith, the Working Group decided not to apply the same limitation to defences relating to fraud by the assignor. If the debtor could not waive such defences, the assignee would have to investigate in order to ensure that no fraud was committed by the assignor in the context of the original contract. The limitation under paragraph (2), however, applies not only to defences relating to fraud by the assignee alone but also to defences relating to fraud by the assignee in collusion with the assignor. In this context, the Working Group considered other defences that should not be waived. In order to accommodate certain export transactions, the Working Group decided that the defence relating to the invalidity of the original contract should be made subject to a waiver. As to defences against the protected holder of a negotiable instrument, relating to signature requirements and agency (article 30 (1) *(c)* of the United Nations Convention on International Bills of Exchange and International Promissory Notes), the Working Group thought that no parallel should be drawn between a receivable and a negotiable instrument. Such a parallelism would not be in line with draft article 4 (1) *(b)* which excluded the transfer of instruments by endorsement and delivery or by mere delivery. It would also be inconsistent with the will of the parties who chose not to incorporate their receivables into a negotiable instrument.

60. In line with paragraph (1), paragraph (3) requires for the modification of a waiver the form of a signed written agreement. Parties need to be warned of the legal consequences of such a modification, which should be easily proven, if necessary. With a view to ensuring that a modification, which may be agreed upon by the assignor and the debtor, does not affect the rights of the assignee, paragraph (3) subjects a modification to the procedure foreseen in draft article 22 (2) for the modification of the original contract after notification of the assignment (i.e. to actual or constructive consent by the assignee; see para. 65).

Article 22. *Modification of the original contract*

References:

A/CN.9/420, para. 109
A/CN.9/432, paras. 210-217
A/CN.9/434, paras. 198-204
A/CN.9/447, paras. 122-135
A/CN.9/456, paras. 205 and 206

Commentary

61. The modification of the original contract is an issue that arises frequently in practice. A modification may be necessary for various reasons. For example: a substantial change in the main circumstances under which the contract was concluded may make it unfair for the assignor to deliver the goods as promised; equipment or materials different from the ones agreed may be necessary in the construction of a project; or a change in the general circumstances may require an extension of the deadline for payment agreed upon in the original contract. To the extent that such contract modifications raise issues relating to rights and obligations as between the assignor and the debtor or as between the assignor and the assignee, they are generally addressed in the relevant contract or in legislation. However, to the extent that such contract modifications raise the question of the rights and obligations as between the assignee and the debtor, the relevant issues may not be fully addressed either in the contract or in legislation.

62. The primary goal of draft article 22, therefore, is to ensure that the debtor has as against the assignee the right to modify the original contract in the sense that, in the case of reduction in the price, the debtor is discharged by paying the reduced price and does not owe the price of the original receivable. However, draft article 22 is not intended to interfere with the relationship between the assignor and the debtor. For this reason, the requirements and the legal consequences of an effective modification agreement as between the assignor and the debtor remain subject to the law governing that agreement. A secondary goal of draft article 22 is to protect the assignee by ensuring that the assignee acquires rights under the modified original contract. This means that, if the price of the goods or services offered under the original contract is modified, the debtor may not raise the modification of the contract as a defence, asserting that the assignee has no rights under the new modified contract, and refuse to pay even the reduced price (any rights that the assignee might have against the assignor, however, for breach of contract are not affected; see para. 67).

63. The basic rule introduced by draft article 22 is that, before notification, the assignor and the debtor may freely modify their contract. They do not need to obtain the consent of the assignee, even though the assignor may have undertaken in the assignment contract to abstain from any contract modifications without the consent of the assignee or may be under the good faith obligation to inform the assignee about a contract modification. The breach of such an undertaking may give rise to liability of the assignor as against the assignee. It does not, however, invalidate an agreement modifying the original contract, since such an approach would inappropriately affect the rights of the debtor. After notification, a modification of the original contract becomes effective as against the assignee only subject to the actual or constructive consent of the assignee. The underlying rationale is that, after notification, the assignee becomes a party to a triangular relationship and any change in that relationship which affects the assignee's rights should not bind the assignee against its will. This approach is in line with draft article 19, according to which, before notification, the debtor may discharge its obligation in accordance with the original contract.

64. Paragraph (1) requires an agreement between the assignor and the debtor, which is concluded before notification of the assignment and affects the assignee's rights. If the agreement does not affect the rights of the assignee, paragraph (1) does not apply. If the agreement is concluded after notification, paragraph (2) applies. The Working Group may wish to specify that the relevant point of time is the time when notification is received by the debtor, since as of that time the debtor may discharge its obligation only in accordance with the assignee's payment instructions.

65. Paragraph (2) is formulated in a negative way, since the rule is that, after notification, a modification is ineffective as against the assignee, unless an additional requirement is met. "Ineffective" means that the assignee may claim the original receivable and the debtor is not fully discharged by paying less than the value of the original receivable. Paragraph (2) requires actual or constructive consent of the assignee. Actual consent is required if the receivable has been fully earned by performance and the assignee has thus the reasonable expectation that it will receive payment of the original receivable. For the purposes of the draft Convention, a receivable is considered as being fully earned when an invoice is issued, even if the relevant contract has only partially been performed. As a result, for such partially performed contracts to be modified, the actual consent of the assignee is required. Constructive consent exists if the original contract allows modifications or a reasonable assignee would have given its consent. Such a consent is sufficient if the receivable is not fully earned and the modification is foreseen in the original contract or a reasonable assignee would have consented to such a modification. In requiring actual or constructive consent, the Working Group intended to combine certainty with flexibility. If a receivable is fully earned, its modification affects the reasonable expectations of the assignee and has thus to be subject to the consent of the assignee. If, on the other hand, a receivable is not fully earned, there is no need to overburden the parties with requirements that may affect the efficient operation of a contract. In particular, in long-term contracts, such as project financing or debt-restructuring arrangements (in which receivables are offered as security in return for a reduction in the interest rate or an extension of the maturity date), a requirement that the assignor would have to obtain the assignee's consent to every little contract modification could slow down the operations while creating an unwelcome burden for the assignee. This problem, however, would normally not arise, since in practice parties tend to resolve such issues through an agreement as to which types of modifications require the assignee's consent. In the absence of such an agreement or in the case of breach of such an agreement by the assignor, paragraph (2) would provide an adequate degree of protection to the debtor.

66. The Working Group chose not to refer to general principles, such as good faith or reasonable commercial standards, in order to justify a modification. Those standards were thought to be introducing an undesirable degree of uncertainty, since there is no uniform understanding as to their meaning. The Working Group was not favourable either to limiting the situations in which the assignee's consent would be necessary to those in which a modifica-

tion of the original contract would result in "material adverse effects" to the assignee.

67. Paragraph (3) is intended to preserve any right of the assignee as against the assignor if a modification of the original contract violates an agreement between the assignor and the assignee. This means that, if a modification is effective as against the assignee, without the assignee's consent, the debtor is discharged by paying in accordance with the contract as modified. The assignee, however, may turn against the assignor and claim the balance of the original receivable and compensation for any additional damage suffered, if the modification is in breach of an agreement between the assignor and the assignee.

Article 23. *Recovery of payments*

References:

A/CN.9/420, paras. 145-148
A/CN.9/432, paras. 239-244
A/CN.9/434, paras. 94 and 213-215
A/CN.9/447, paras. 136-139
A/CN.9/456, paras. 207 and 208

Commentary

68. In practice, the debtor may pay the assignee before the assignor performs its obligations under the original contract. If the assignee does not perform, the question arises whether the debtor may recover from the assignee the sums paid. This question is of particular importance if the assignor becomes insolvent and thus recovery of payments from the assignor is impossible.

69. As a complement to the principle that the debtor's legal position should not be worsened as a result of the assignment, draft article 23 provides that the debtor's position should not be improved either. If the debtor pays the assignee and the assignor does not properly perform the original contract, the debtor has recourse against the assignor under the original contract and the law governing that contract, but not against the assignee. This means that the debtor bears the risk of insolvency of its contractual partner, which would be the case anyway in the absence of an assignment. Noting that a different approach is followed in the Ottawa Convention, the Working Group thought that the difference was justified. A guarantee of performance of the original contract by the assignee may be appropriate in the specific factoring situations addressed in the Ottawa Convention, but was thought to be inappropriate in the context of other financing or service transactions, including factoring transactions which had a predominant service element.

70. There are certain limitations to the rule contained in draft article 23. Under consumer-protection law, the consumer debtor might have the right to declare the original contract avoided and to recover from the assignee any payments made to the assignee. The Working Group thought that the draft Convention should not override the consumer-protection law prevailing in the country in which the debtor is located (i.e. has its place of business; as to the meaning of the term "primarily" and the problem arising in this context, see para. 58). The Working Group also thought that a general reference to public policy in this context would not be necessary. The notions of public policy and mandatory law would apply under draft articles 30 and 31 through the mechanism of private international law rules, providing wide recognition of law applicable outside the draft Convention. The Working Group also thought that multiple references to public policy and mandatory law could inappropriately widen the scope of the limitation and detract from the certainty achieved in the draft Convention.

71. A second limitation is introduced to the rule contained in draft article 23 through the reference to draft article 20. This reference is intended to ensure that the debtor's defences and rights of set-off are preserved with regard to payment in installments, where some installments have been made while other installments are outstanding. Such rights would only apply where the debtor would need to reduce or avoid payment of outstanding installments.

Section III. Other parties

Article 24. *Competing rights of several assignees*

References:

A/CN.9/420, paras. 149-164
A/CN.9/432, paras. 245-260
A/CN.9/434, paras. 238-254
A/CN.9/445, paras. 18-29
A/CN.9/455, paras. 18-31
A/CN.9/456, paras. 209 and 210

Commentary

72. In practice, receivables may be assigned several times. Such "duplicate assignments" are normal practice in the case of assignments by way of security in which different parts of the same receivables are offered as security for credit. In such a case, the question arises what is the order of priority in payment among the various claimants. Priority does not mean validity. It presupposes a valid assignment (substantive or material validity is dealt with in chapter III, while formal validity is left to law applicable outside the draft Convention; for a secretariat suggestion to deal in the draft Convention with formal validity as well, see A/CN.9/WG.II/WP.104, remarks to chapter III). Priority does not prejudge either the issue whether the assignee with priority will retain all the proceeds of payment or turn over any remaining balance to the assignor or to the next claimant in the order of priority. This matter depends on whether an outright assignment or an assignment by way of security is involved, a matter left to law applicable outside the draft Convention. Priority does not affect the discharge of the debtor either. The debtor paying in accordance with draft article 19 (or, if draft article 19 is not applicable, in accordance with the law applicable under draft article 28) is dis-

charged, even if payment is made to an assignee who does not have priority (under draft article 24 or, if draft article 24 is not applicable, under draft article 29). Whether that assignee will retain the proceeds of payment is a matter of priority to be resolved among the various claimants in accordance with the law applicable under draft article 24 (or draft article 29).

73. However, several outright assignments of the same receivables made by the same assignor may be a fraudulent or an unconscionable act. While fraud is a rare occurrence, simple inadvertence on the part of the assignor, or ignorance of the legal effects of a previous assignment, occurs frequently. A typical example is the assignment to a receivables financier in return for working capital and to an inventory financier or to a supplier of materials on credit with a retention of title or other security interest until full payment of the price of the inventory or of the materials. In such a case, the conflict may be between a global assignment (an assignment of all present and future receivables) to the receivables financier and an assignment to the inventory financier or the supplier of the proceeds from the sale of the inventory or materials. With a view to achieving certainty with regard to the rights of the various creditors of the assignor and thus facilitating the assignor's access to credit, the Working Group proceeded with its work on the assumption that such conflicts would be addressed. If the assignment to the inventory financier or to the supplier is contractual, such conflicts are clearly within the scope of the draft Convention. However, this may not be the case, if the assignment occurs by operation of law, since, under draft article 2 (1), the draft Convention covers only assignments by way of agreement and not by operation of law. The Working Group may, therefore, wish to clarify that any conflicts of priority between an inventory financier or a supplier with a statutory right in any proceeds and an assignee come under the ambit of the draft Convention. In this context, the Working Group may wish to consider whether the priority rules in the draft Convention would be appropriate, since the inventory financier or the supplier might expect that priority issues would be governed by the law of the location of the inventory or the materials supplied.

74. Draft article 24 is intended to apply to a conflict between a Convention and a non-Convention assignee (e.g. between a domestic and a foreign assignee of domestic receivables). Such an approach would not affect domestic practices. In fact, one of the reasons for which the Working Group decided to turn the priority rules into private international law rules was that such rules would not negatively affect domestic practices. The domestic assignee would have to meet the requirements of the same law, since by definition, in a conflict with a foreign assignee, the domestic assignee, the assignor and the debtor would be located in the same jurisdiction. Assuming that the draft Convention defines "location" of a legal entity by reference to its place of incorporation or place of central administration and that that place is different from the place of business, the applicable law may be different. However, even in such a case the domestic assignee could predict that the draft Convention could apply, since: the domestic assignee would be located in a Contracting State (the same State in which the assignor is located; otherwise the draft Convention would not apply); and the domestic assignee would know that the assignor is, for example, a branch of a foreign entity. The Working Group may wish to confirm this understanding (see also A/CN.9/WG.II/WP.104, remarks 3-5 to draft article 1).

75. In the case of several outright assignments of the same receivables by the same assignor the issue may not be who will receive payment first (i.e. an issue of priority) but who will receive payment at all (i.e. an issue of effectiveness). In such assignments, the assignee with "priority" takes all the proceeds (provided that it has a valid claim) and no other assignee can obtain payment. However, the draft Convention does not differentiate between outright assignments and assignments by way of security, since: third parties may have no way of knowing whether an assignment by way of security or an outright assignment is involved in a particular case; and, in any case, such differentiation would be very difficult in view of the wide divergences existing among the various legal systems with regard to security rights.

76. Draft article 24 contains a private international law rule subjecting priority issues to the law of the assignor's location (the meaning of the term "location" has not been decided yet by the Working Group; for the secretariat's suggestions, see A/CN.9/WG.II/WP.104, remarks 4-10 to draft article 5). The Working Group recognized that a private international law rule cannot lead to uniformity in terms of commercial results, since one law may give priority to the first assignee in time, while another law may give priority to the first assignee to notify the debtor or to register certain data about the assignment. However, the Working Group also recognized that there is clear commercial value in a private international law rule that would subject priority issues to the law of a single and easily determinable jurisdiction. Such a rule would constitute a significant improvement of the present situation in which assignees tend to either reject international receivables as security for credit or to accept them at a low value, since they either cannot determine which law may govern priority or they have to meet the requirements of several jurisdictions in order to ensure that they will have priority.

77. If, under the applicable law, priority is based on the time of assignment, an assignee considering whether to finance certain receivables has to rely on the assignor's representations and possibly on representations made by other parties or on information available in a certain market. If the applicable law determines priority based on priority in notification of the debtor, again a prospective assignee has to rely on representations by the assignor and by the debtor, as well as on information available from other sources. In such jurisdictions: priority with regard to future receivables will not be obtainable at all at the time of assignment (at that time the identity of the debtors is not known); and priority with regard to receivables assigned in bulk will only be obtainable at the additional cost of notifying all the debtors. If, on the other hand, under the law applicable, priority is obtained by way of making certain data part of a public record, beyond representations by the assignor or other parties, prospective assignees would have that public record to rely on. In addition, assignees filing the required data would have an objective way of acquiring priority.

78. In this context, the Working Group may wish to clarify that, if, under the law of the assignor's location (which must be in a Contracting State for the draft Convention to apply), priority is determined on the basis of the time of notification of the debtor, the notification needs to be given in accordance with the draft Convention. If notification were to be given in accordance with the domestic law of the assignor's location and that law invalidates notifications relating to future receivables, assignees would be unable to establish priority with regard to future receivables, a result that would have a negative impact on the availability and the cost of credit (see para. 36).

79. Departing from the approach traditionally followed in many legal systems, subjecting priority issues to the lex situs of the receivable (the law of the country where payment is due or the debtor is located), the Working Group decided to subject priority issues to the law of the assignor's location. The Working Group took this approach, considering that the traditional rule is no longer regarded as a workable or efficient rule. In the increasingly common case of a global assignment of present and future receivables (e.g. under factoring, invoice discounting or securitization agreements) application of the law of the lex situs of the receivable fails to yield a single governing law. It also exposes prospective assignees to the burden of having to determine the notional situs of each receivable separately. Application of the law governing the receivable or of the law chosen by the parties produces similar results. Different priority rules would govern priority with regard to the various receivables in a pool of receivables and, in the case of future receivables, the parties would not be able to determine with any certainty the law applicable to priority, a factor that may defeat a transaction or, at least, raise the cost of credit. Application of the law chosen by the assignor and the assignee in particular could allow the assignor, acting in collusion with a claimant in order to obtain a special benefit, to determine the priority among several claimants. In addition, the law chosen by the parties would be completely unworkable in the case of several assignments of the same receivables either by the same or by different assignees, since different laws could apply to the same priority conflicts.

80. Whether location is defined by reference to the place of incorporation or of the place of central administration of a legal entity, application of the law of the assignor's location will result in the application of the law of a single jurisdiction and one that can be easily determined at the time of assignment. It will thus eliminate the difficulties mentioned above. Furthermore, application of the law of the assignor's location will be particularly compatible with the law of jurisdictions with public registration requirements in which third parties would normally look at the law of the assignor's location to determine the manner in which they could establish priority.

81. The Working Group considered the question of the point of time which should be taken into account in the determination of the location of the assignor. If the assignor relocated after one and before another assignment, the assignee with priority under the law of the initial location should not lose its priority. On the other hand, the right of claimants in the new location should not be forever subject to the rights of claimants from other jurisdictions. However, it was widely felt that relocation of the assignor between duplicate assignments occurred rarely in practice and a rule aimed at addressing the issue would make draft article 24 unnecessarily complex. The Working Group, therefore, decided to leave the matter to other law applicable outside the draft Convention.

82. As mentioned above, the Working Group decided to depart from the traditional approach in order to accommodate the most common practices that involve bulk assignments of all present and future receivables. The Working Group decided that no exception should be made for assignments of single, high-value, existing receivables. Introducing a different priority rule with regard to the assignment of such receivables would detract from the certainty achieved in draft article 24. It would be very difficult to clearly define "high-value receivables". In addition, in a bulk assignment containing both "high-value"and "low-value" receivables, priority would be subject to different laws.

83. In the context of its discussion of the law applicable to priority issues, the Working Group considered the question of potential conflicts with the Convention on the Law Applicable to Contractual Obligations (Rome, 1980; hereinafter referred to as "the Rome Convention"), whose article 12 deals with the law applicable to assignment. The Working Group thought that the reference to a regional instrument applicable to contractual obligations should not prevent the preparation of a specialized legal regime for universal application to financing and service transactions. The Working Group also took note of the fact that great uncertainty exists as to whether article 12 of the Rome Convention addresses priority issues and, if so, whether the law applicable is the law chosen by the parties or the law governing the receivable. The Working Group thought that it would be useful to resolve this uncertainty and that, in any case, priority issues (i.e. the proprietary effects of an assignment) should not be made subject to the law governing the receivable or to the law chosen by the parties (see paras. 79 and 80 and 88). It was agreed, however, that States should have the right to opt out of chapter V (draft article 34) and that, in any case, they could settle any conflict between the draft Convention and the Rome Convention by determining which text they wish to give precedence to (draft article 33).

84. While draft article 24 subjects priority conflicts between several assignees who obtain the same receivables from the same assignor to the law of the assignor's location, it recognizes the interest of the parties involved in a conflict to negotiate and to relinquish priority in favour of a subordinate claimant where commercial considerations so warrant. In order to afford maximum flexibility and to reflect prevailing business practices, paragraph (2) was drafted to make it clear that a valid subordination need not take the form of a direct subordination agreement between the assignee with priority and the beneficiary of the subordination agreement. It can also be effected unilaterally, e.g. by way of an undertaking of the first ranking assignee to the assignor (whether in the contract of assignment or an independent, written or oral, agreement), empowering the assignor to make a second assignment ranking first in pri-

ority. The term "unilaterally" is further intended to clarify that the beneficiary of the subordination (the second assignee) need not offer consideration in exchange for the priority granted by the unilateral subordination. Furthermore, paragraph (2) clarifies that an effective subordination need not specifically identify the intended beneficiary or beneficiaries ("any existing or future assignees") and can instead employ generic language.

85. The Working Group also considered several alternatives of a substantive law priority rule but failed to reach agreement. For this reason, two alternative substantive law priority rules are offered in the annex to the draft Convention for States to choose from. As a result, States might be confused as to what is the recommended approach. In addition, if a State does not choose any of those two alternatives (e.g. because its priority regime is based on priority in time of notification of the debtor), the full range of alternatives will, in effect, be reproduced. Moreover, the annex would need further development so as to be workable. In view of the above, the Working Group may wish to consider replacing the annex with a few general principles referring the matter of preparing model priority provisions to the procedure for the revision and amendment of the draft Convention (see A/CN.9/WG.II/WP.104, remarks to the annex).

Article 25. *Competing rights of assignee and creditors of the assignor or insolvency administrator*

References:

A/CN.9/420, paras. 149-164
A/CN.9/434, paras. 216-237 and 255-258
A/CN.9/445, paras. 30-44
A/CN.9/455, paras. 32-40
A/CN.9/456, paras. 211-222

Commentary

86. Draft article 25 is intended to settle conflicts of priority between an assignee and creditors of the assignor or the administrator in the insolvency of the assignor. The draft Convention is not intended to address issues arising in the case of insolvency of the assignee, unless the assignee makes a subsequent assignment and becomes an assignor. The Working Group thought that such issues are beyond the scope of the draft Convention. The draft Convention is not intended to address issues arising in the context of the debtor's insolvency either. It is assumed that the assignee would have in the receivables the same rights that the assignor would have in the case of insolvency of the debtor. As already mentioned, priority is defined as a preference (in payment or other discharge; see A/CN.9/WG.II/WP.105, para. 57). The exact legal consequences of such preference depend on whether an assignment by way of security or an outright assignment is involved, a matter left to law applicable outside the draft Convention. In any case, preference established under the draft Convention is not intended to interfere with special preference or super-priority rights existing under national insolvency law (see para. 93).

87. Conflicts of priority covered by draft article 25 may arise if the assignment is made before attachment or commencement of an insolvency proceeding (if the assignment is made thereafter, no conflict arises; any rights that the assignee may obtain are subordinate to the rights of the assignor's creditors or the insolvency administrator). If priority is based on the time of assignment, the fact that the assignment is made before attachment or commencement of the insolvency proceeding is sufficient to establish that the receivables are separated from the assignor's estate (if an outright assignment is involved) or that the assignee may satisfy its claim in preference to unsecured creditors (if an assignment by way of security is involved). If, however, priority is determined on the basis of notification of the debtor or registration of certain data about the assignment in a public registry, the fact that the assignment is made before attachment or commencement of the insolvency proceeding is not sufficient for the purpose of establishing priority. Notification of the debtor or registration needs also to take place before attachment or commencement of the insolvency proceeding.

88. Draft article 25 subjects such priority conflicts to the law of the assignor's location (the issue of the meaning of the assignor's location has not been decided yet; see A/CN.9/WG.II/WP.104, remarks 4-10 to draft article 5). As already mentioned (see paras. 79 and 80), the location of the assignor as a connecting factor presents the advantage of simplicity and predictability for a number of reasons, including that: it provides a single point of reference; it could be ascertained at the time of even a bulk assignment of future receivables; it would be suitable even for legal systems in which registration is practised; and it would result in the application of the law of the jurisdiction in which any insolvency proceeding with regard to the assignor would be most likely to commence. This last aspect of the application of the law of the assignor's location is essential, since it appropriately addresses the issue of the relationship between the draft Convention and the applicable insolvency law. Indeed the thrust of draft article 25 is to ensure that, in most cases, the law governing priority under draft article 25 and the law governing the insolvency of the assignor are the laws of one and the same jurisdiction (the assignor's main jurisdiction, whether place of incorporation or of central administration). In such a situation, any conflict between the draft Convention and the applicable insolvency law would be resolved by the rules of law of that jurisdiction. In all other cases in which an insolvency proceeding with regard to the assets and affairs of the assignor is commenced in a State other than the State of the assignor's main jurisdiction (e.g. a jurisdiction in which the assignor has assets), the draft Convention gives way to rules of law that reflect the public policy of the State in which a dispute is adjudicated, either before a court or an arbitral tribunal (draft article 25 (3)). In addition, in such cases, the draft Convention is intended to avoid any interference with certain rights of the assignor's creditors or of the insolvency administrator, which, although not reflective of public policy, are part of mandatory law (draft article 25 (4)). The Working Group may wish to extend the application of those two limitations to court proceedings outside insolvency. In any case, non-consensual, preferential rights would not be affected (draft article 25 (5)).

89. The public policy meant in paragraph (3) is the international public policy of the forum State. Recourse to such public policy has only a negative effect in the sense that it may defeat the application of a provision of the law applicable under draft article 25 which is manifestly contrary to the public policy of the forum State (e.g. a rule giving priority to a foreign State for taxes). As a result, a certain person may be bypassed in the determination of priority, while priority will be determined by other provisions of the applicable law. The public policy of draft article 25, however, may not have a positive effect; it may not result in the positive application of a priority rule of the forum State which reflects public policy (e.g. a rule giving priority to employees in the forum State). For that reason, the Working Group decided to include paragraph (5) in draft article 25, specifically preserving non-consensual, super-priority rights (see para. 93).

90. For a priority rule to be set aside under paragraph (3), it must be "manifestly contrary" to the public policy of the forum State. The notion of "manifestly contrary" is used in international texts (including article 6 of the UNCITRAL Model Law on Cross-Border Insolvency, article 16 of the Rome Convention and article 18 of the Inter-American Convention on the Law Applicable to International Contracts) as a qualification of public policy. The purpose of such a qualification is to emphasize that public policy exceptions should be interpreted restrictively and paragraph (3) should be invoked only in exceptional circumstances concerning matters of fundamental importance for the forum State. Otherwise, the certainty achieved by draft article 25 could be seriously compromised, a result that would have a negative impact on the availability and the cost of credit on the basis of receivables (the term "manifestly contrary" is used also in draft article 31; see para. 114).

91. If the rule, with which the priority rule of the law applicable conflicts, falls short of being reflective of public policy but is a rule of mandatory law, under paragraph (4) special rights of creditors of the assignor and of the insolvency administrator are not affected "except as provided by this article". These words mean that the priority rule of the law applicable is not set aside; it applies to the extent that it does not affect certain special rights. The rationale underlying this approach is that the priority rules of the law applicable are themselves mandatory rules and setting them aside in favour of mandatory rules of the forum would result in uncertainty and thus have a negative impact on the availability and the cost of credit. At the same time, however, the Working Group recognized that an exception should be made for cases in which special rights of the assignor's creditors or of the insolvency administrator are affected.

92. Such special rights include, but are not limited to, 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. They also include any right of the insolvency administrator: 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; 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; to encumber the assigned receivables with the expenses of the insolvency administrator in performing the original contract, or 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. If the assigned receivables constitute security for indebtedness or other obligations, the special rights protected under paragraph (4) include any rights existing under insolvency rules or procedures generally governing the insolvency of the assignor that: permit the insolvency administrator to encumber the assigned receivables; provide for a stay of the right of individual assignees or creditors of the assignor to collect the receivables during the insolvency proceeding; permit the substitution of the assigned receivables for new receivables of at least equal value; provide 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. They also include 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 (draft article 25 (5)).

93. As already mentioned, the forum State may, under paragraph (3), refuse to give priority, for example, to a foreign State for taxes, but may not apply its own priority rule giving priority to employees in the forum State. Paragraph (5) is intended to achieve exactly this result, namely to allow the forum State to apply its own priority rules, in the case where a priority rule applicable under paragraphs (1) and (2) is manifestly contrary to the forum's public policy, and to give priority to non-consensual rights reflecting the forum's public policy (for paragraphs (5) and (6), see A/CN.9/WG.II/WP.104, remarks 2-3 to draft article 25). Paragraph (5) goes a step further. It allows a State to list in a declaration the non-consensual, super-priority rights that should prevail over the rights of an assignee under the draft Convention. This possibility for declarations is intended to enhance certainty in that it provides a mechanism for assignees to know which super-priority rights would prevail over their rights. It is formulated as a possibility (not as an obligation) and it appears within square brackets, since the Working Group thought that it might reduce the acceptability of the draft Convention, in particular to the extent that a declaration would have the effect of limiting the national super-priority rights that would be preserved (for a secretariat suggestion to delete the bracketed language in paragraph (5), see A/CN.9/WG.II/WP.104, remark 2 to draft article 25).

[Article 26. *Competing rights with respect to payments*

References:

A/CN.9/447, paras. 63-68
A/CN.9/456, paras. 160-167

Commentary[1]

94. Draft article 26 has a twin goal, to ensure that the assignee has with respect to proceeds the same priority as in the receivables and, at the same time, to grant the assignee with respect to a limited type of proceeds and under certain conditions the same in rem rights that the assignee has in the receivables. Proceeds are described as everything that is given in payment of the receivables. They include proceeds of proceeds, while payment includes both payment in cash and in kind (e.g. goods returned by the debtor to the assignor).

95. The in rem nature of the right in proceeds is an issue that is distinct from the issue of priority. A claimant with priority in accordance with the law applicable under the draft Convention will obtain payment first and will prevail over another claimant (other than a claimant with a super-priority, non-consensual right; see draft article 25 (5)) whether that other claimant has a right in rem or ad personam (for this reason the secretariat suggests to treat those issues in separate provisions; see A/CN.9/WG.II/WP.104, remarks to draft article 26). However, the in rem nature of the right of a claimant with respect to proceeds may be decisive in the case of insolvency. If the claimant with priority has a right in rem with respect to proceeds, that claimant will be able to separate the proceeds from the insolvency estate (if an outright assignment is involved) or be treated as a secured creditor and receive payment before unsecured creditors (if an assignment by way of security is involved). If, on the other hand, a claimant with priority has a right ad personam, it will receive payment proportionately with other unsecured creditors, if there is any balance left after payment of any creditors with special privileges and security rights.

96. Under paragraph (1), the assignee with priority who receives payment may retain that payment. The implicit limitation, which may need to be stated explicitly, is that the assignee may not retain more than the value of its receivable (as to this matter and the question of interest, see A/CN.9/WG.II/WP.104, remark 3 to draft article 26). Paragraph (2) is intended to grant the assignee an in rem right in certain types of proceeds (i.e. cash proceeds) and only under certain conditions (i.e. if the assignor receives payment on behalf of the assignee and keeps those proceeds separated from its own assets). This limited provision is aimed at facilitating practices, such as undisclosed invoice discounting and securitization, to the extent that a right in rem with respect to proceeds will increase certainty as to payment to the assignee, in particular in the case of insolvency. Such a provision could have a significantly positive impact on the availability and the cost of credit (for a secretariat suggestion to extend the application of this provision to other types of proceeds if the conditions set forth in paragraph (2) are met, see A/CN.9/WG.II/WP.104, remark 2 to draft article 26).

97. Paragraphs (3) to (5) deal with the issue of priority in proceeds. They are based on a distinction between proceeds that are receivables and other types of proceeds (e.g. goods). The rule embodied in those paragraphs is that priority in proceeds that are receivables is governed by the law of the assignor's location, while priority in other types of assets is governed by the lex rei sitae. With regard to receivables, the Working Group has been able to replace the lex situs of the receivable with the law of the assignor's location. The main reason for this approach is that the application of the lex situs of the receivable would produce unworkable results, since: in the case of future receivables, the lex situs would not be known at the time of the assignment; and, in the case of bulk assignments, priority issues with regard to the same pool of receivable would be subject to different laws. As to proceeds in the form of tangible assets, the Working Group has not found it possible to depart from the lex rei sitae, since such an approach could frustrate the expectations of third parties in the country where the asset is located.

[1]In view of the tentative character of draft article 26, the commentary on this provision is brief. The complete commentary will be written after the finalization of this provision by the Working Group.

CHAPTER V. CONFLICT OF LAWS

References:

A/CN.9/420, paras. 185-187
A/CN.9/445, paras. 52-55
A/CN.9/455, paras. 67-73

Commentary

98. Chapter V is intended to state a few general principles that are widely adopted but not recognized in all legal systems. It is not intended to deal with all assignment-related issues in an exhaustive way, or to displace or to contradict any international legislative text existing in this field of law. In particular, draft articles 27 and 28 reflect the generally accepted principles: that the assignment contract is subject to the law chosen by the assignor and the assignee; and that the relationship between the assignee and the debtor is subject to the law governing the receivable. Draft articles 30 and 31 also reflect generally accepted principles that the applicable law may be set aside if it is manifestly contrary to mandatory law or public policy.

99. If the Working Group decides that this chapter may apply irrespective of the scope provisions of the draft Convention, if the forum is in a Contracting State (see A/CN.9/WG.II/WP.104, remarks to chapter V), chapter V would broaden the scope of application of the innovative priority rules of the draft Convention. Unlike draft articles 27, 28, 30 and 31, the priority rule contained in draft article 29 breaks new ground in that it addresses an issue which is not clearly or appropriately resolved in current law. In line with draft articles 24 to 26, draft article 29 subjects priority issues to the law of a single and easily determinable jurisdiction, i.e. the law of the assignor's location (for an analysis of the advantages of this approach, see paras. 79 and 80 and 88).

Article 27. *Law applicable to the contract of assignment*

References:

A/CN.9/420, paras. 188-196
A/CN.9/445, paras. 52-74
A/CN.9/455, paras. 67-119

Commentary

100. Draft article 27 is intended to reflect the principle of party autonomy with the respect to the law applicable to the contract of assignment. While being widely recognized, this principle is not known in all legal systems. Under paragraph (1), the assignor and the assignee may agree on the law applicable to the contract of assignment. The conclusion, the validity and the rights and obligations of the assignor and the assignee arising under the contract of assignment are intended to be covered by the expression "contract of assignment" (for a suggestion to state this result explicitly, see A/CN.9/WG.II/WP.104, remarks to draft article 27). However, if the assignment is just a clause in the financing contract, this expression is not intended to cover the financing contract as a whole.

101. Paragraph (1) provides that the choice of law must be express. The Working Group recognized that an implicit choice would be in line with current trends in private international law. However, it was widely felt that a different approach is warranted in the case of financing transactions, in which certainty is of utmost importance and may determine whether a transaction will take place and at what cost.

102. Paragraph (2) deals with the exceptional situations in which the parties have not agreed on the law applicable to the contract of assignment or in which the parties have agreed but their agreement is later found to be invalid. It refers to the closest-connection test, which may result in the application of the law of the assignor's location (e.g. in the case of an assignment by way of sale) or of the law of the assignee's location (e.g. in an assignment by way of security made in the context of a credit transaction). In an attempt to combine flexibility with certainty, paragraph (2) introduces a rebuttable presumption that the State with the closest connection to the contract is the law of the assignor's location. Location in this context means place of business. In view of the limited scope of application of paragraph (2), the Working Group thought that such a reference to the place of business would not undermine the certainty necessary for financing transactions.

103. Paragraph (3) is intended to reflect the generally accepted principle that the parties to a contract may not set aside mandatory rules of the law applicable in the absence of a choice of law by the parties, if the contract is connected with one other State only.

Article 28. *Law applicable to the rights and obligations of the assignee and the debtor*

References:

A/CN.9/420, paras. 197-200
A/CN.9/445, paras. 65-69
A/CN.9/455, paras. 92-104 and 117

Commentary

104. In line with the principle that the draft Convention should not change the legal position of the debtor, draft article 28 reflects a generally acceptable rule, providing that the relationship between the assignee and the debtor is subject to the law governing the receivable. In the case of contractual receivables, that law would be the law governing the original contract, which is likely to be the law chosen by the assignor and the debtor and, in the absence of a choice of law, the law of the country with the closest connection to the original contract. The Working Group decided to avoid including detailed rules as to the law governing the receivable. It was widely felt that such elaborate rules are not necessary in a chapter which is intended to set forth some general rules, without addressing all assignment-related private international law issues. It was also generally thought that it would be inappropriate to attempt to determine the law governing the receivable in the wide variety of contracts that might be at the origin of a receivable (e.g. contracts of sale, insurance contracts, contracts relating to financial markets operations).

105. Inspired by article 12 (2) of the Rome Convention, draft article 28 refers to the relationship between the assignee and the debtor. The assignment does not create a contractual relationship between the assignee and the debtor. The assignor remains the contractual partner of the debtor and the debtor retains its rights as against the assignor. However, a de facto relationship is established between the assignee and the debtor based on the fact that the assignee may notify the debtor and request payment. In order to avoid leaving any doubt, draft article 28 explicitly states that it covers the conditions under which the assignment can be invoked as against the debtor and the debtor's discharge (as to rights of set-off, see A/CN.9/WG.II/WP.104 remarks 1-2 to draft article 28).

106. Draft article 28 also covers assignability as an issue relating to payment by and discharge of the debtor. Whether both contractual and statutory assignability is covered depends on the scope of chapter V, an issue not yet decided by the Working Group. If chapter V applies to transactions falling within the scope of the draft Convention, contractual assignability will be subject to draft article 10, while statutory assignability will be governed by the law specified in draft article 28 under the condition that the forum is in a Contracting State. If, on the other hand, chapter V applies even to transactions falling outside the scope of the draft Convention, contractual assignability with respect to such transactions and statutory assignability with respect to transactions falling both within and outside the scope of the draft Convention will be subject to the law applicable under draft article 28 (in such a case, contractual assignability with respect to transactions falling within the scope of the draft Convention will be subject to draft article 10). The Working Group considered that draft article 28 would govern statutory prohibitions aimed at the protection of the debtor (e.g. restrictions on the assignment of sovereign receivables) or at the protection of the assignor (e.g. restrictions on the assignment of wages, pensions and payments under life insurance policies). The Working Group's considerations were based on the assumption that if the application of the law governing the receivable was contrary to a statutory prohibition contained in a public-policy or mandatory-law rule of the forum and aimed at the protection of the assignor, it could be set aside or even replaced by the mandatory law rule of the forum or another

State (see A/CN.9/WG.II/WP.104, remark 3 to draft article 28). The Working Group may wish to reconsider the matter. Statutory prohibitions aimed at the protection of the assignor result in the invalidation of assignments as between the parties thereto and, consequently, as against the debtor. As a result, the issue of the relationship between the assignee and the debtor does not even arise in this context. Thus, it may be more appropriate to subject such statutory prohibitions to the law of the assignor's location than the to law governing the receivable.

[Article 29. *Law applicable to conflicts of priority*

References:

A/CN.9/445, paras. 70-74
A/CN.9/455, paras. 105-110

Commentary[2]

107. Draft article 29 appears within square brackets pending determination by the Working Group of the scope or purpose of chapter V. Retention of draft article 29 is meaningful only if chapter V is to apply to transactions beyond those falling within the scope of the draft Convention under chapter I. If chapter V has the same scope as the other parts of the draft Convention, draft article 29 repeats rules reflected in draft articles 24 to 26 and may thus be deleted. If retained, draft article 29 would need to be aligned with draft articles 24 to 26 (see A/CN.9/WG.II/WP.104, remarks to draft article 29). If chapter V is to apply irrespective of chapter I, it may need to be specified that it applies also to conflicts involving a subsequent assignment as if the subsequent assignee is the initial assignee (this matter is addressed in chapter I, draft article 2 *(b)*).

108. As a private international law rule, draft article 29 has the goal of providing certainty with regard to the law applicable to conflicts of priority. Such certainty is dependent upon making reference to the law of a single and easily determinable jurisdiction (the law of the assignor's incorporation or place of central administration; see A/CN.9/WG.II/WP.104, remarks 4-10 to draft article 5).

109. Priority is defined in draft article 5 *(i)* as a preference (in payment or other discharge) and draft article 29 specifies the parties between which such conflicts may arise. In view of the fact that the debtor is not one of those parties, priority does not relate to the debtor's discharge. Therefore, the debtor being discharged under the law governing the receivable cannot be asked to pay again the party with priority under the law of the assignor's location.

Article 30. *Mandatory rules*

Reference:

A/CN.9/455, paras. 111-117

[2]Depending on the decision of the Working Group as to the scope or purpose of chapter V, draft article 29, which is intended to reproduce the rules contained in draft articles 24 to 26, may be retained or deleted. For this reason, only a brief commentary is provided at this stage.

Commentary

110. Paragraph (1) is intended to reflect a generally accepted principle in private international law, according to which mandatory law of the forum may be applied irrespective of the law otherwise applicable. Mandatory law in this context does not refer to law that cannot be derogated from by agreement but to law of fundamental importance, such as consumer-protection law or criminal law (*loi de police*).

111. Paragraph (2) introduces a different rule, namely that a court in a Contracting State may apply neither its own law nor the law applicable under draft articles 27 and 28, but the law of a third country on the grounds that the matters settled in those provisions have a close connection with that country.

112. Departing from the approach followed in private international law texts, the Working Group decided to limit the scope of draft article 30 to the application of the law applicable to the contract of assignment and to the relationship between the assignee and the debtor. It was generally thought that such an approach is warranted with regard to the law applicable to priority issues, since priority rules are of a mandatory nature themselves and setting them aside in favour of the mandatory rules of the forum or another State would inadvertently result in uncertainty as to the rights of third parties, a result that would have a negative impact on the availability and the cost of credit.

Article 31. *Public policy*

Reference:

A/CN.9/455, paras. 118 and 119

Commentary

113. Draft article 31 differs from draft article 30 in that draft article 31 has only a negative effect, i.e. that of setting aside a rule of the applicable law if it is manifestly contrary to the public policy of the forum. Unlike draft article 30, draft article 31 does not have a positive effect, i.e. does not result in the positive application of the public policy of the forum. In other terms, public policy in the context of draft article 31 means international public policy and not the domestic public policy of the forum.

114. In line with the approach followed in other international legal texts, the qualification "manifestly" has been added before the words "contrary to public policy" (see para. 90). It should be noted that it is the application of the applicable law to a particular case and not the applicable law itself which needs to be manifestly contrary to the public policy of the forum. The application of a foreign law, therefore, cannot be refused on the grounds that the law itself, in general, is considered to be inimical to the public order of the forum but only if the application of a particular rule in a concrete case would be repugnant to the public policy of the forum.

E. Analytical Commentary to the Convention on Assignment [in Receivables Financing] [of Receivables in International Trade]: note by the secretariat

(A/CN.9/470) [Original: English]

CONTENTS

INTRODUCTION

1. The United Nations Commission on International Trade Law (UNCITRAL), at its twenty-eighth session, in 1995, decided to entrust the Working Group on International Contract Practices with the task of preparing a uniform law on assignment in receivables financing.[1] The Commission, at that session, had before it a report of the Secretary-General entitled "Assignment in receivables financing: discussion and preliminary draft of uniform rules" (A/CN.9/412). It was agreed that the report, setting forth the concerns and the purposes underlying the project and the possible contents of the uniform law, would provide a useful basis for the deliberations of the Working Group.[2]

2. The Working Group commenced its work at its twenty-fourth session, in November 1995, by considering the report of the Secretary-General.[3] At its twenty-fifth to thirty-first sessions, the Working Group considered revised draft articles prepared by the secretariat,[4] and, at its twenty-ninth to thirty-first sessions, it adopted a draft Convention, the exact title of which remains to be determined.[5] At its thirty-first session, the Working Group had before it a preliminary commentary on the draft Convention prepared by the secretariat.[6] At that session, the Working Group agreed that the secretariat would finalize and distribute the commentary with a view to assisting the Commission in reviewing and finalizing the draft Convention at its thirty-third session, to be held in New York from 12 June to 7 July 2000.[7]

3. The present note has been prepared pursuant to that agreement of the Working Group. It is intended to provide a summary of the reasons for the adoption of a certain provision and its main objectives, along with explanations and interpretations of particular terms, without, however, giving a complete account of the *travaux préparatoires* or of all proposals and provisions that were not retained. For the benefit of those seeking fuller information on the history of a given provision, the commentary lists the references to the relevant portions of the reports of the eight sessions of the Working Group.[8] After finalization of the draft Convention, the Commission may wish to request the secretariat to prepare the final version of the commentary, which would serve as an unofficial legislative guide and a tool for interpretation.

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

[2] Ibid., para. 379. At its twenty-sixth and twenty-seventh sessions, the Commission had considered two other reports of the Secretary-General (A/CN.9/378/Add.3 and A/CN.9/397). For the Commission's discussion of those reports, see ibid., *Forty-eighth Session, Supplement No. 17* (A/48/17), paras. 297-30,1 and *Forty-ninth Session, Supplement No. 17* (A/49/17), paras. 208-214, respectively.

[3] The report of the Working Group is contained in document A/CN.9/420.

[4] The draft articles prepared by the secretariat are contained in documents A/CN.9/WG.II/WP.87, A/CN.9/WG.II/WP.89, A/CN.9/WG.II/WP.93, A/CN.9/WG.II/WP.96, A/CN.9/WG.II/WP.98, A/CN.9/WG.II/WP.102 and A/CN.9/WG.II/WP.104. The reports of the Working Group are contained in documents A/CN.9/420, A/CN.9/432, A/CN.9/434, A/CN.9/445, A/CN.9/447, A/CN.9/455, A/CN.9/456 and A/CN.9/466.

[5] A/CN.9/455, para. 17; A/CN.9/456, para. 18; and A/CN.9/466, para. 19.

[6] A/CN.9/WG.II/WP.105 and A/CN.9/WG.II/WP.106.

[7] A/CN.9/466, para. 215.

[8] In order to avoid confusion, no special reference is made to previous article numbers, which, in the course of the preparation of the draft Convention, were altered several times. However, any earlier number will be apparent from the relevant discussion in the reports of the Working Group. Annex II to A/CN.9/466 contains an index to the final renumbering of articles.

ANALYTICAL COMMENTARY

Draft Convention on Assignment [in Receivables Financing] [of Receivables in International Trade]

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 content and choice of legal regime applicable to assignments [of receivables] in international trade [constitute an obstacle to financing transactions],

Desiring to establish principles and adopt rules [relating to the assignment of receivables] that would create certainty and transparency and promote modernization of law relating to [assignments of receivables] [receivables financing] [including but not limited to assignments used in factoring, forfaiting, securitization, project financing, and refinancing,] while protecting existing [financing] [assignment] practices and facilitating the development of new practices,

Also desiring to ensure the adequate protection of the interests of the debtor in the case of an assignment of receivables,

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

Have agreed as follows:

References:

A/CN.9/420, paras. 14-18
A/CN.9/434, paras. 14-16
A/CN.9/445, paras. 120-124
A/CN.9/455, paras. 157-159
A/CN.9/456, paras. 19-21 and 60-65

Commentary

Title

4. The Commission may wish to consider whether the reference to receivables financing or to international trade should be retained in the title of the draft Convention (for a non-exhaustive list and a brief description of the practices covered by the draft Convention, see paras. 6-12). A reference to financing could be misleading in that it could give the impression that the scope of the draft Convention is limited to purely financing transactions, excluding impor-

tant service transactions (e.g. assignments in international factoring transactions in which insurance against debtor-default, book-keeping or collection services is provided; chapter I does not exclude such transactions in that it does not refer to the financing purpose or context of the assignment; see para. 25). A reference to international trade may sufficiently reflect the overall objective of the draft Convention to facilitate the movement of goods and services across borders and appropriately clarify that the draft Convention applies to assignments with an international and commercial element, without attempting to regulate consumer assignments or domestic assignments of domestic receivables. On the other hand, such a reference to international trade may inadvertently give the impression that the draft Convention applies only to assignments of receivables generated in international trade and not to the assignment of consumer receivables; the international assignment of domestic receivables; or the assignment of receivables arising from loan or other transactions that may not involve the sale of goods or the provision of services. In addition, such a reference might fail to reflect the fact that the draft Convention might affect domestic assignments of domestic receivables, for example, in that it is intended to provide which law applies to a conflict between a domestic and a foreign assignee of domestic receivables (on this matter, see also paras. 21 and 169). On balance, it may be preferable to include a reference to international trade in the title and to explain the matter in the commentary.

Preamble

5. The preamble is intended to serve as a statement of the general principles on which the draft Convention is based and which, under article 8, may be used to fill gaps left in the draft Convention. These principles include the facilitation of both commercial and consumer credit at more affordable rates, which is in the interest of all parties involved, assignors, assignees and debtors; the principle of debtor protection, according to which the debtor's legal position is not affected unless expressly stated otherwise in the draft Convention; the promotion of the movement of goods and services across borders; the enhancement of certainty and predictability as to the rights of parties involved in assignment-related transactions; the modernization and harmonization of domestic and international laws on assignment, both at the substantive and the private international law level; the facilitation of new practices and the avoidance of interference with current practices; the avoidance of interference with competition. As to the reference to financing, which appears in the preamble within square brackets, the Commission may wish to consider retaining it, since it could usefully clarify the main objectives of the draft Convention, without limiting the scope of the draft Convention, a matter that could be further explained in the commentary.

Transactions covered

6. In view of the broad definition of a "receivable" in article 2 *(a)* ("contractual right to payment of a monetary sum"), the draft Convention applies to a wide array of transactions. In particular, the draft Convention covers the assignment of trade receivables (arising from the sale of goods or services between businesses), consumer receivables (arising from consumer transactions), financial receivables (arising from financial transactions, such as loans, deposit accounts, swaps and derivatives) and sovereign receivables (arising from transactions with a governmental authority). With a view to clarifying the context of application of the draft Convention, those practices are described briefly in the following paragraphs. The list of practices cannot be exhaustive, in particular in view of the fact that new practices are rapidly developing which the draft Convention cannot ignore.

7. First of all, included are traditional financing techniques relating to trade receivables, such as factoring (the outright sale of a large number of receivables with or without recourse) and forfaiting (the outright sale of single, large-value receivables, whether they are documentary or not, without recourse). In these types of transactions, assignors assign to financiers their rights in receivables arising from the sale of the assignors' goods or services. The assignment in such transactions is normally an outright transfer but may also, for various reasons (e.g. stamp duty), be for security purposes. The purchase price is adjusted depending on the risk and the time involved in the collection of the underlying receivable. Beyond their traditional forms, those transactions have developed a number of variants tailored to meet the various needs of parties to international trade transactions. For example, in invoice discounting, there is an outright sale of a large number of receivables without debtor-notification but with full recourse against the assignor in the case of debtor default; in maturity factoring, there is full administration of the sales ledger, collection from debtors and protection against bad debts, but without any financial facility; in international factoring, receivables are assigned to a factor in the country of the assignor ("export factor") and then from the export factor to another factor in the country of the debtor ("import factor") for collection purposes, while the factors do not have recourse against the assignor in the case of debtor default (non-recourse factoring). All those transactions are covered in the draft Convention regardless of their form.

8. The draft Convention also covers innovative financing techniques, such as securitization and project finance, which may relate to a wide range of receivables, including consumer receivables. In a securitization transaction, an assignor, creating receivables through its own efforts ("originator"), assigns, usually by way of an outright transfer, these receivables to an entity ("special purpose vehicle" or "SPV"), fully owned by the assignor and specially created for the purpose of buying the receivables and paying their price with the money received from investors to whom the SPV sells the receivables or securities backed by the receivables. The segregation of the receivables from the originator's other assets allows the price paid by investors (or the money lent) to be linked to the financial strength of the receivables assigned and not to the creditworthiness of the assignor. It also insulates the receivables from the risk of the insolvency of the originator. Accordingly, the originator may be able to obtain more credit than would be warranted on the basis of its own credit rating. In addition, by gaining access to international securities markets, the originator may be able to obtain credit at a cost that would be lower than the average cost of commercial bank-based credit. In large-scale, revenue-generating infrastructure

projects, sponsors raise the initial capital costs by borrowing against the future revenue stream of the project. Thus, hydroelectric dams are financed on the security of the future income flow from electricity fees, telephone systems are paid for by the future revenues from telecommunications charges and highways are constructed with funds raised through the assignment of future toll-road receipts. Given the draft Convention's applicability to future receivables, these types of project finance may be reduced to transfers, usually for purposes of security, of the future receivables to be generated by the project being financed. In this context, it should be emphasized that the draft Convention's exclusion of assignments made for personal, family or household purposes will not act to exclude consumer receivables.

9. Many other forms of traditional transactions relating to the assignment of a receivable generated in the context of a financial transaction will also be covered. These include the opening of a credit line on the security of the balance in a deposit account; the refinancing of loans for improving capital to obligations ratio or for portfolio diversification purposes; the assignment of the insurance company's contingent obligation to pay upon loss; and the assignment of rights arising under a letter of credit. Also covered are less traditional transactions, such as loan syndications and participations, swaps and other derivatives, repurchase agreements ("repos") and interbank payments.

10. A "swap" is a transaction in which two parties agree to exchange one stream of obligations for another. The first swaps related to interest payments involved currencies, commodities, energy and credit obligations, and the range continues to expand. The underlying rationale for entering into a swap is to transfer the risks involved with a particular obligation to another party better able or willing to manage them. In a traditional interest swap, a creditworthy entity borrowing money at a fixed interest rate exchanges that interest with a variable interest rate at which a less secure entity borrows a similar sum. As a result, a less creditworthy entity, for a fee, in effect borrows money at a fixed rate. No payment of capital occurs between the parties to the swap (that comes from the underlying loan transactions). Between such parties, only interest payments take place. In practice, the interest payments are offset against each other and only a net payment is made by the party with the larger payment due. This residual payment is a contractual right to a monetary sum and is, therefore, within the broad definition of article 2. There are several variations of a simple interest rate swap. For example, an investor may buy a fixed rate bond and swap the fixed rate for a floating rate from a bank; the bank may take security over the bond to secure the investor's obligations to pay amounts equal to the fixed rate.

11. Derivatives are a more general class of transaction of which swaps are a specific instance. They share the common characteristic of creating payment obligations that are determined by the price of an underlying transaction (this is why they are described as being "derived" from those transactions). With the exception of interest swaps, most derivative contracts relate to the difference between the agreed future price of an asset on a future date and the actual market price on that date. For example, in a futures contract, one party agrees to deliver to the other party on a specified future date ("the maturity date") a specified asset (e.g. a commodity, currency, a debt, equity security or basket of securities, a bank deposit or any other category of property) at a price agreed at the time of the contract and payable on the maturity date. Futures are usually performed by the payment of the difference between the price agreed upon at the time of the contract and the market price on the maturity date, and not by physical delivery and payment in full on that date (they are called derivatives because settlement is not by actual performance of the sale or deposit contract but by a difference payment derived from an actual asset and an actual price; the contract is derived from an ordinary commercial contract). In options, the buyer has the right (but not the obligation) to acquire ("call option") or to sell ("put option") an asset in the future at a price fixed when the option is entered into. Repurchase agreements (or repos) are contracts under which one party sells a (usually fixed interest) security to another and simultaneously agrees to repurchase the security at a future date at an agreed price that includes allowance for the interest on the cash consideration and the accrued interest on the security. The payments are contingent upon the delivery or return of security. Within inter-bank payment systems and securities settlement systems, participants have obligations to make a large number of individual payments and also rights to receive similar numbers of payments from other participants. These obligations and rights are resolved into payments due to or from the system as a whole (typically using a central counter-party) or due between each pair of participants.

12. Derivatives, including swaps and repos, are usually transacted within a master netting agreement (e.g. the Master Netting Agreement prepared by the International Swaps and Derivatives Association ("ISDA")), which provides for the net settlement of payments due in the same currency on the same date. The agreement may also make provision, upon the default by a party, for the termination of all outstanding transactions at their replacement or fair market cost, conversion of such sums into a single currency and netting into a single payment by one party to the other (issues relating to netting are addressed in the ISDA Model Netting Act, adopted by 21 States). Set off (the discharge of reciprocal claims to the extent of the smaller claim) and netting (at its simplest, the ability to set off reciprocal claims on the insolvency of a counter-party) may come within the ambit of the draft Convention to the extent that the net obligation arising under a derivatives contract may be assigned.

CHAPTER I. SCOPE OF APPLICATION

Commentary

Structure of chapter I

13. In chapter I, scope-related issues are dealt with in different provisions for the sake of clarity and simplicity in the text. Article 1 defines the substantive scope in general terms, as well as the territorial scope of application of the draft Convention. Articles 2 and 3 define the substantive scope in more detailed terms (definitions of assignment, receivable and internationality of an assignment or a re-

ceivable). Articles 4 and 5 deal with excluded transactions and transactions treated differently. Article 6 appears in chapter II of the draft Convention since the terms defined therein do not raise mainly or only scope-related issues. The Commission may wish, however, to consider whether, in view of the importance of the term "location", its definition in article 6 *(i)* should be moved to article 2 or 3 or to a new article in chapter I.

Article 1. *Scope of application*

(1) This Convention applies to:

(a) Assignments of international receivables and to international assignments of receivables as defined in this chapter, if, at the time of the conclusion of the contract of assignment, the assignor is located in a Contracting State;

(b) Subsequent assignments provided that any prior assignment is governed by this Convention; and

(c) Subsequent assignments that are governed by this Convention under subparagraph *(a)* of this paragraph, notwithstanding that any prior assignment is not governed by this Convention.

(2) This Convention does not affect the rights and obligations of the debtor unless the debtor is located in a Contracting State or the law governing the receivable is the law of a Contracting State.

[(3) The provisions of chapter V 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. However, those provisions do not apply if a State makes a declaration under article 37.]

(4) The annex to this Convention applies in a Contracting State which has made a declaration under article 40.

References:

A/CN.9/420, paras. 19-32
A/CN.9/432, paras. 13-38
A/CN.9/434, paras. 17-41
A/CN.9/445, paras. 45-48 and 125-145
A/CN.9/447, paras. 143-146
A/CN.9/455, paras. 41-46 and 160-173
A/CN.9/456, paras. 22-37
A/CN.9/466, paras. 145-149

Commentary

Substantive and territorial scope of application

14. Under article 1, the draft Convention applies to assignments of receivables (for a definition of the terms "assignment" and "receivable", see paras. 26, 27, 29 and 30). There are two conditions for the draft Convention to apply. There needs to be an element of internationality (for an exception, see para. 18) and an element of a territorial connection between certain parties and a Contracting State. The element of internationality may relate to the assignment or to the receivable. Accordingly, the draft Convention applies to assignments of international receivables, whether or not the assignments are international or domestic, and to international assignments of receivables, even if the receivables are domestic. As a result, the assignment of receivables is covered whether or not those receivables arise in the context of international or domestic trade, as long as the assignment itself is international (for comments on internationality, see paras. 38-40). The element of territorial connection may relate to the assignor only or to the assignor and the debtor. For the application of the provisions of the draft Convention other than the debtor-related provisions (e.g. chapter IV, section II), only the assignor needs to be located in a Contracting State. For the application of the draft Convention as a whole, the debtor too needs to be located in a Contracting State (or the law governing the receivable needs to be the law of a Contracting State; for a discussion of the term "location", see paras. 66-70).

15. This approach to the issue of the territorial scope of the draft Convention is based on the assumption that the main disputes that the draft Convention would be called upon to resolve would be addressed if the assignor (and, only for the application of the debtor-related provisions, the debtor too) is located in a Contracting State. Such disputes could arise with regard to rights of the assignee against the assignor flowing from the breach of a warranty; enforcement of the receivables by the assignee against the debtor; discharge of the debtor; defences of the debtor towards the assignee; relative rights of the assignee and the administrator in the insolvency of the assignor; relative priority rights of the assignee and a competing assignee; and the effectiveness of subsequent assignments. The Working Group also considered that enforcement would normally be sought in the place of the assignor's or the debtor's location and there is thus no need to make reference to the assignee's location; and that application of the provisions of the draft Convention other than those contained in section II of chapter IV would not affect the debtor and there is thus no need to preclude the application of all the provisions of the draft Convention if the debtor is not located in a Contracting State.

16. As a result of this approach, the territorial scope of application of the draft Convention is sufficiently broad and thus it is not necessary to extend it to cases in which no party may be located in a Contracting State but the law of a Contracting State is applicable by virtue of the private international law rules of the forum. The Working Group thought that such an approach might introduce uncertainty, at least, to the extent that private international law on assignment is not uniform and, in any case, parties would not know at the time of the conclusion of a transaction where a dispute might arise and, as a result, which private international law rules might apply. However, if the forum is located in a non-Contracting State, the courts are not bound by the draft Convention. Therefore, despite the fact that article 1 does not refer to the application of the draft Convention by virtue of private international law rules, the courts of a non-Contracting State may not be precluded from applying the draft Convention as part of the law designated by their private international law rules. In this connection, the particular question arises as to whether the courts of a non-Contracting State would apply the draft

Convention only if the courts of a Contracting State would apply it (i.e. if the substantive and territorial requirements of the draft Convention are met) or even if the courts of a Contracting State would not apply it (i.e. if the requirements of chapter I are not met). The Commission may wish to address this question.

17. Under article 1 (2), the debtor-related provisions of the draft Convention may apply to situations in which the debtor might not be located in a Contracting State but the law of a Contracting State governs the assigned receivable. In this context, a different approach to the territorial scope of application of the draft Convention is followed, since the Working Group felt that certainty as to the application of the draft Convention would not be unduly compromised. Furthermore, unlike paragraph (1), paragraph (2) of article 1 does not specify the time at which the debtor needs to be located in a Contracting State or the receivable needs to be governed by the law of a Contracting State (on this matter, see also paras. 202 and 219). The Commission may wish to specify that time. The time of the conclusion of the original contract may be preferable from a debtor protection point of view, since it would enhance predictability of the application of the draft Convention to the debtor-related issues. Such an approach would also be consistent with article 39, which refers to the location of the debtor in a State making a declaration at the time of the original contract. However, such an approach would result in the assignor, the assignee and third parties not being able to determine, in the case of future receivables, whether the draft Convention would apply to the rights and obligations of the debtor (for a related problem with regard to future receivables assigned domestically, see paras. 39 and 40).

Subsequent assignments

18. In line with the principle of continuatio juris, the draft Convention applies also to subsequent assignments made, for example, in the context of international factoring, securitization and refinancing transactions, provided that any prior assignment is governed by the draft Convention (and irrespective of whether there is an element of internationality). Accordingly, even a domestic assignment of domestic receivables may be brought into the ambit of the draft Convention if it is subsequent to an international assignment. The reason for such an approach is that, unless all assignments in a chain of assignments were made subject to one and the same legal regime, it would be very difficult to address assignment-related issues in a consistent manner. The Commission may wish to consider whether the draft Convention should apply to subsequent assignments only if the assignor is located in a Contracting State.

19. The draft Convention also applies to subsequent assignments that in themselves fall under article 1 *(a)*, whether or not any prior assignment is governed by the draft Convention (as this is not a separate type of assignment, the Commission may wish to reconsider the placement of article 1 (1) *(c)*). As a result, the draft Convention may apply only to some of the assignments in a chain of assignments. This result is a departure from the principle of continuatio juris. However, the Working Group considered it necessary to follow this approach since parties to assignments in securitization transactions, in which the first assignment is a domestic one and relates to domestic receivables, should not be deprived of the benefits that may be derived from the application of the draft Convention. This approach is based on the assumption that it would not unduly interfere with domestic practices (on this matter, see para. 20).

Relationship with national law

20. As a result of covering in the draft Convention international assignments of domestic receivables or even domestic assignments of domestic receivables made in the context of subsequent assignments, business parties in domestic transactions could benefit from increased access to international financial markets and thus to potentially lower-cost credit. The interests of assignors, protected, for example, by national law prohibitions of assignments of future receivables or of global assignments, would not be unduly interfered with to the extent that the draft Convention does not preclude the assignor from offering its receivables to different lenders for credit (e.g. to a supplier of materials on credit and to a financing institution for working capital) in that it does not give priority to one over the other. The interests of debtors, protected by national legislation, would not be unduly interfered with either, at least to the extent that the draft Convention requires that the debtor be located in a Contracting State and limits the effects of an assignment on the debtor to mainly payment to another creditor in the country and in the currency stipulated in the original contract. The interests of domestic assignees would not be unduly interfered with either, because the draft Convention does not give priority to a foreign over a domestic assignee. It merely specifies which national law would govern priority. In addition, for a conflict between a domestic and a foreign assignee to be covered by the draft Convention (article 24 *(a)* (i)), the assignor would need to be located in a Contracting State (article 1 *(a)*) and that State, by definition in a domestic assignment of a domestic receivable (article 3), would be the State in which both the domestic debtor and the domestic assignee would be located. However, as a result of the central-administration location rule, different laws might apply to a conflict between an assignment by a branch office and an assignment by the head office, if the branch or the head office is not located in a Contracting State.

Scope of chapter V

21. Under article 1 (3), the private international law provisions of chapter V apply to assignments with an international element as defined in article 3, whether or not the assignor or the debtor is located in a Contracting State. The justification for limiting the scope of application of chapter V lies in the wish to reduce any conflicts with other conventions, dealing with private international law issues of assignment (e.g. the European Union Convention on the Law Applicable to Contractual Obligations, Rome, 1980 ("the Rome Convention") and the Inter-American Convention on the Law Applicable to International Contracts, Mexico City, 1994 ("the Mexico City Convention")). The Commission may wish to reconsider this approach. Defining the scope of application of private international law provisions by reference to substantive or even artificial notions of internationality would not appear to be appropri-

ate. In any case, the question of conflicts with other private international law texts is already sufficiently addressed in articles 36 (giving precedence to any other international legislative text that deals with the same matters) and 37 (allowing States to opt out of chapter V).

22. The Commission may also wish to consider dealing with the issue of the hierarchy between the substantive and the private international law provisions of the draft Convention with a view to ensuring that the substantive law provisions apply first (the matter is addressed in article 24 by the words "with the exception of matters which are settled elsewhere in this Convention"). A new provision could be inserted at the beginning of chapter V that would deal with the scope of chapter V, the hierarchy between chapter V and the rest of the draft Convention and with the right of States to opt out of chapter V. Such a provision could read along the following lines: "Chapter V applies to assignments independently of the provisions of chapter I. In the case of an assignment to which this Convention applies in accordance with chapter I, chapter V applies to matters that are not settled elsewhere in this Convention. If a State makes a declaration under article 37, chapter V does not apply." Article 37 would serve to explain the effect of such a declaration (for further comments on the scope and purpose of chapter V, see paras. 187-189). If such an approach were to be followed, article 1 (3) could be deleted or refer only to the possibility for a reservation by States with respect to the application of chapter V.

Application of the annex

23. Article 24 of the draft Convention refers priority issues to the law of the assignor's location (as to the meaning of "location", see article 6 *(i)*). In recognition of the fact that some States may need to modernize or adjust their priority rules, article 1 (4) allows States to opt into one of the two substantive law priority rules set forth in the annex. Article 40 (2) clarifies the effect of a declaration under article 1 (4), namely, that, for the purposes of article 24, the law of the assignor's location is the priority rule of the annex chosen by the Contracting State in which the assignor is located (for the choices given to States and effects of declarations, see para. 216). Once article 40 is finalized, the Commission may wish to reconsider the formulation and the proper place of article 1 (4) in the draft Convention.

Article 2. *Assignment of receivables*

For the purposes of this Convention:

(a) "assignment" means the transfer by agreement from one person ("assignor") to another person ("assignee") of the assignor's contractual right to payment of a monetary sum ("receivable") from a third person ("the debtor"). The creation of rights in receivables as security for indebtedness or other obligation is deemed to be a transfer;

(b) in the case of an assignment by the initial or any other assignee ("subsequent assignment"), the person who makes that assignment is the assignor and the person to whom that assignment is made is the assignee.

References:

A/CN.9/420, paras. 33-44
A/CN.9/432, paras. 39-69 and 257
A/CN.9/434, paras. 62-77
A/CN.9/445, paras. 146-153
A/CN.9/456, paras. 38-43
A/CN.9/466, paras. 87-91

Commentary

Assignment and contract of assignment or financing contract

24. Like most legal systems, the draft Convention recognizes the distinction between the assignment itself as a transfer of property and the contract of assignment as a transaction creating personal obligations (in other words, between the assignment and its causa, that is, a sale, security agreement, gift or payment). This distinction may be apparent where the contract of assignment and the assignment take place at different points of time and are part of separate agreements (as, e.g. in securitization and project finance transactions). It may not be as apparent where the two transactions take place simultaneously and are embodied in a single contract (as, e.g. in factoring transactions). While the main focus of the draft Convention is on assignment as a transfer of property rights in receivables, the draft Convention deals also with contractual matters in articles 13 to 16 and 28. However, the draft Convention does not address the issue of the relationship between the assignment and the contract of assignment. This relationship is treated differently from one legal system to another. In some legal systems, the effectiveness of an assignment depends on the validity of the contract. In other legal systems, the assignment is treated as an "abstract transaction", that is, legally independent of the underlying contract in the sense that defects in the underlying contract do not automatically affect the validity of the assignment and vice versa. In yet other legal systems, the assignment is a separate act but may be affected by the invalidity of the contract. In practice, a defect in the contract of assignment will often lead to the nullification of the assignment itself. However, in those limited cases in which only the contract may be invalid, the assignor will have only a personal claim against the assignee limited to restitution of any unjust enrichment and will not be able to have the assigned receivable separated from the assignee's insolvency estate or to oppose the attachment of the assigned receivable in the hands of the assignee.

25. In particular, the draft Convention does not refer to the purpose of an assignment, that is whether an assignment is made for purely financing purposes or for book-keeping, collection, insurance, risk-management, portfolio diversification or other purposes. Such qualifications interfere with the purpose of the contract of assignment or the financing contract and would result in: inappropriately limiting the scope of the draft Convention to purely financing transactions and in creating a special regime on assignments for financing purposes, even though one is not needed; uncertainty, since there is no universal understanding of the terms "financing" and "commercial", and a uniform definition is neither feasible nor desirable; and in unnecessarily exclud-

ing from the scope of the draft Convention important transactions in which only services may be provided (with regard to the possible impact of such an approach on national law, see para. 20; as to potential conflicts with the Convention on International Factoring, Ottawa, 1980 ("the Ottawa Convention"), see paras. 204-206).

"Transfer by agreement"

26. With the intention of bringing within the ambit of the draft Convention, in addition to assignments, other practices involving the transfer of property rights in receivables, such as contractual subrogation or pledge, article 2 defines "assignment" as a transfer. This approach takes into account the fact that significant receivables financing transactions, such as factoring, take place, in some legal systems, by way of a contractual subrogation or pledge. Rather than creating a new type of assignment, the draft Convention is aimed at providing uniform rules on assignment and assignment-related practices with an international element, which, although covered in theory by currently existing national law, could not be sufficiently developed in view of the inherent limitations on the application of national law to matters of mandatory law in an international context. The reference to transfers "by agreement" is intended to exclude transfers by operation of law (e.g. statutory subrogation).

27. Both outright transfers, including those made for security purposes, and assignments by way of security are intended to be covered, whether "value, credit or services" is given or promised at the time of the assignment or at an earlier time (consideration is not mentioned in article 2, since it is a matter for the contract of assignment or the financing contract). In order to avoid any ambiguity as to whether an assignment by way of security is covered, the matter is addressed explicitly in article 2 *(a)*, which creates the legal fiction that, for the purposes of the draft Convention, the creation of security rights in receivables is deemed to be a transfer. However, the draft Convention does not define outright assignments and assignments by way of security. This matter is left to other law applicable outside the draft Convention, since, in view of the wide divergences existing among legal systems as to the classification of transfers, an assignment by way of security could in fact possess attributes of a sale, while a sale might be used as a security device.

"From one person to another person"

28. Both the assignor and the assignee can be legal entities or individuals, whether merchants or consumers. In particular, the assignment between individuals is covered, unless the assignee is a consumer and the assignment is made for his/her own consumer purposes (article 4 (1) *(a)*). As a result, the assignment of credit card receivables or of loans secured by real estate in securitization transactions and of toll-road receipts in project financing arrangements fall within the ambit of the draft Convention. In view of the fact that in the draft Convention the singular includes the plural and vice versa, an assignment made by many persons (e.g. joint owners of receivables) or to many persons (e.g. a syndicate of financiers) is also covered (so is the assignment of more than one receivable). In the determination, however, of the territorial scope of application or internationality, each assignment should be considered a separate assignment and meet the conditions of chapter I for the draft Convention to apply (as to cases involving multiple debtors, see para. 38). In an assignment to a trustee acting on behalf of several persons, whether there are one or several assignees depends on the exact authority of the trustee, that is, whether the trustee was a mere agent or had the authority to make substantive decisions. This matter is left to law outside the draft Convention.

"Contractual right to payment of a monetary sum"

29. Receivables arising from any type of contract are intended to be covered, whether the contract exists at the time of assignment or not. The transfer of receivables arising by operation of law, such as tort receivables, receivables arising in the context of unjust enrichment, tax receivables or receivables determined in court judgements or arbitral awards, are excluded, unless they are confirmed in a settlement agreement. What is a "contractual" right is a matter of interpretation in accordance with the law governing that right. However, contractual receivables, the assignment of which is covered by the draft Convention, include receivables arising under contracts for the sale of goods or the provision of services, whether those contracts are commercial or consumer transactions; receivables in the form of royalties arising from the licensing of intellectual property; damages for breach of contract; interest if it was owed under the original contract; dividends arising from shares, whether they were declared at, or arose after, the time of the assignment; the right to receive payment of the proceeds of an independent guarantee or a letter of credit; and receivables in the form of credit balances in deposit accounts or securities transactions.

30. While, in principle, the right of the assignor/seller to any goods returned by the buyer (debtor) is not a receivable under the draft Convention, as between the assignor and the assignee, it is treated as a receivable to the extent that any goods returned by the buyer take the place of the assigned receivable (article 16; but, as against third parties, the assignee does not have a right to any returned goods, since they are excluded from the definition of "proceeds" in article 6 *(k)*). Furthermore, non-monetary rights convertible into a monetary sum (e.g. the assignment of rights arising in a commodity swap) are receivables the assignment of which is covered. To the extent that the conversion is foreseen in the original contract, this result is implicit in article 2; to the extent that such a conversion is not foreseen in the original contract, it is in line with the Working Group's decision to cover the assignment of non-monetary rights converted into damages for breach of contract. This result is also implicit in article 5, which relates to swaps and derivatives transactions. The Commission may wish to reflect this understanding explicitly in the draft Convention. The Commission may also wish to consider whether unilateral assignments should be covered, although such assignments are rare in practice. In addition, after acceptance of the proceeds of the assigned receivable a de facto assignment would exist. However, in the few situations where a unilateral assignment is made and a conflict arises with a Convention assignment before any implicit agreement by way of the assignee's acceptance of payment, it may be desirable to ensure that the conflict is resolved under article 24 on the basis of the law of the assignor's location.

Non-monetary performance rights

31. The assignment of other, non-monetary, contractual rights (e.g. the right to performance, the right to declare the contract avoided or the right to request delivery of a commodity or a security under a swap or repurchase agreement) or of composite rights (e.g. the right to present documents and demand payment under an independent guarantee or a letter of credit) is not covered. The Commission may wish to reconsider the exclusion of assignment of non-monetary contractual rights to performance. Such an approach may result in parts of one and the same assignment transaction being submitted to different legal regimes, since in practice assignments often relate to all rights arising under a contract and assignees rely on non-monetary performance rights as well (draft article 12.101 of the European Contract Principles refers to "rights to payment or other performance";[9] however, draft article 1.1 of the Principles on Assignment of the International Institute for the Unification of Private Law ("Unidroit") is modelled on article 2).[10] Assignments of contracts, which involve an assignment of contractual rights and a delegation of obligations, are not covered either. While such transactions may form part of financial arrangements, the financier would normally rely mainly on the receivables. As to the delegation of obligations, the Working Group thought that it should not be covered because it raises issues going far beyond the desirable scope of the draft Convention.

Parts or undivided interests in receivables

32. Important practices that are intended to be covered by the draft Convention involve the assignment of parts or undivided interests in receivables (e.g. securitization, loan syndication and participation). The effectiveness of such partial assignments is not common ground in all legal systems. Article 9, therefore, validates such assignments. However, in view of the fact that there is no explicit reference in chapter I to such partial assignments, it is not clear whether the draft Convention as a whole applies to them (including the debtor protection provisions, the application of which is important if the receivable is partially assigned to several assignees and the debtor incurs expenses to pay to more than one person). The Commission may, therefore, wish to clarify this matter in article 2 *(a)*, by adding, for example, before the words "of the assignor's contractual right" the words "all or part" (the matter is addressed in draft article 12.103 of the European Contract Principles and draft article 1.3 of the Unidroit Principles on Assignment).

33. With regard to monetary rights that are divisible, the debtor will normally be able to make partial payment. This may not be the case with non-monetary performance rights, since dividing performance rights could change the relationship between performance and counter-performance and have a negative impact on the legal position of the debtor. Therefore, if the Commission decides to include assignments of non-monetary performance rights within the ambit of the draft Convention, it may wish to clarify that a partial assignment of such rights is permitted only if they may be divided (e.g. if the debtor is entitled to make a separate payment for the part of the performance assigned; see draft article 12.103 (2) of the European Contract Principles). In addition, the Commission may wish to consider the position of the debtor in the case of a partial assignment of a monetary receivable. In practice, creditors are interested in a normal flow of payments and it is, therefore, unlikely that a debtor would be requested to pay more than one assignee. In addition, under article 17, such a request could only involve different payees in the same country and could not result in any additional cost to the debtor.

34. However, the matter may need to be addressed explicitly. The Commission may wish to consider, for example, that, at the discretion of the debtor, a notification should be treated as ineffective if the related payment instruction instructs the debtor to pay to a designated payee less than the amount due under the original contract. Such an approach would result in covering all combinations of single or multiple assignments of parts or undivided interests in receivables, whether they involve lump-sum or periodic payments. It would also result in protecting the debtor in a sufficient but flexible way, without prescribing, in a regulatory manner, what the assignor, the debtor or the assignee ought to do and without creating liability. If the debtor is prepared to comply with an instruction to pay multiple assignees, there is no reason to prevent parties from doing what they all want to do. On the other hand, if the debtor pays while being unaware of its right to ignore such a payment instruction, the optional character of the ineffectiveness of the notification would preserve the pro tanto discharge of the debtor as a result of the payment in accordance with payment instructions. Alternatively, in the case of a partial assignment, the identification of a single payee could be made a condition of the effectiveness of a notification and the related payment instruction. In such a case, if the debtor is faced with instructions to pay more than one assignee of parts of a receivable, the debtor could be allowed to obtain a discharge by paying the assignor or the first assignee to notify (additional wording may need to be included in articles 18 and 19). A third alternative may be to establish the debtor's right to seek from the assignor compensation of any additional costs incurred by the debtor as a result of a partial assignment or even a right of set-off against the assignee. In cases where a right to compensation may not adequately protect the debtor against exposure to separate proceedings commenced by the assignor and one or more assignees, the debtor may be given a right to apply for an order for all claimants to be joined in one proceeding, in which a decision will be binding to all (draft article 12.103 (3) and (4) of the European Contract Principles).

Personal rights/statutory assignability

35. Article 2 does not refer to personal rights that by law are not assignable (e.g. wages, pensions, insurance policies and sovereign receivables). It is assumed, however, that statutory limitations on assignment, other than those addressed in article 9, are not intended to be covered (see paras. 84 and 85). The Commission may wish to state this understanding explicitly in article 2 (draft article 12.302 of the European Contract Principles refers to "a performance

[9]Reference is made to the draft available in December 1999, prepared for the Commission on European Contract Law by Professor Roy Goode.

[10]Reference is made to Unidroit 1999, Study L—Doc.65 of December 1999, Working Group for the preparation of Principles on International Commercial Contracts, chapter [...], Assignment of rights, transfer of duties and assignment of contracts, Section I: assignment of rights (draft and explanatory notes prepared by Professor Marcel Fontaine).

which the debtor, by reason of the nature of the performance or the relationship of the debtor and the assignor, could not reasonably be required to render to anyone except the assignor"; and draft article 1.3 of the Unidroit Principles on Assignment refers to rights that have "a personal character or the assignment [of which] is prohibited by the applicable law").

"[Owed by] a third person"

36. Apart from the assignor and the assignee, the debtor too could be a legal entity or an individual, a merchant or a consumer, a governmental authority or financial institution (or there could be a multiplicity of debtors). Unlike the Ottawa Convention, the draft Convention does not exclude commercial practices involving the assignment of contractual receivables owed by consumers, unless the assignment is to a consumer for his/her consumer purposes (articles 4 (1) *(a)*). Assignments of consumer receivables form part of significant practices, such as securitization of credit card receivables, the facilitation of which has the potential to increase access to lower-cost credit by manufacturers, retailers and consumers and, as a result, could facilitate international trade in consumer goods. However, while covering the assignment of consumer receivables, the draft Convention is not intended to override consumer-protection law. This principle flows from the general debtor protection principle enshrined in article 17 (1). It is also reflected in a number of provisions of the draft Convention, as, for example, in articles 21 (1) and 23, under which a consumer-debtor cannot waive any defences and rights of set-off and has a right to recover payments from the assignee, if the consumer protection law applicable in the country of the debtor so provides (for anti-assignment clauses in a consumer context, see para. 100).

37. The assignment of receivables owed by a Government or a public entity is covered, unless they are unassignable by law (a matter that may need to be explicitly clarified; as to statutory limitations, see paras. 84 and 85). However, the State in which the sovereign debtor is located may enter a reservation as to the rule of article 11 that assignments are effective notwithstanding a contractual limitation on assignment (see paras. 213 and 214). Receivables owed by debtors in financial contracts, such as loans, deposit accounts, swaps and derivatives, are also covered by the draft Convention. However, the effectiveness of an assignment in general or only as to the debtor of such a receivable may be left to law outside the draft Convention (article 5). Furthermore, the assignment of one or more than one receivable, whether in whole or in part, owed jointly (i.e. fully) and severally (i.e. independently) by multiple debtors is also covered, provided that the contract from which the assigned receivables arise (hereinafter referred to as "the original contract") is governed by the law of a Contracting State. If, however, the original contract is not governed by the law of a Contracting State and one or more, but not all, debtors are located in a Contracting State, each transaction should be viewed as an independent transaction and thus debtors who are not located in a Contracting State should not be affected by the draft Convention. Otherwise, the predictability as regards the application of the draft Convention to rights and obligations of debtors, which is one of the main objectives of the draft Convention, could be compromised.

Article 3. *Internationality*

A receivable is international if, at the time of the conclusion of the original contract, the assignor and the debtor are located in different States. An assignment is international if, at the time of the conclusion of the contract of assignment, the assignor and the assignee are located in different States.

References:

A/CN.9/420, paras. 26-29
A/CN.9/432, paras. 19-25
A/CN.9/445, paras. 154-167
A/CN.9/456, paras. 44, 45, 227 and 228
A/CN.9/466, paras. 92 and 93

Commentary

38. With a view to achieving certainty in the application of the draft Convention, article 3, following the example of other texts prepared by UNCITRAL or other organizations, defines internationality by reference to the location of the parties (under article 6 *(i)*, "location" means place of business or, in the case of more than one place of business of the assignor and the assignee, the place of central administration or, in the case of no place of business, the habitual residence). In the case of more than one assignor, assignee or debtor, internationality is to be determined for each of those parties separately (see paras. 28 and 37). As a result of article 3, once a receivable is international, its assignment is covered by the draft Convention, whether the receivable is assigned to a domestic or to a foreign assignee. On the other hand, even if a receivable is domestic, its assignment may come within the ambit of the draft Convention if it is international or it is part of a chain of assignments that includes an earlier international assignment (see para. 19).

39. The international character of an assignment is determined at the time it is made, while internationality of a receivable is determined at the time of the conclusion of the original contract ("at the time it arises"). Determining the internationality of a receivable at the time it arises is justified by the need for a potential assignor to know at the time of the conclusion of the original contract which law might apply to a potential assignment. Such knowledge is important for a potential assignor to be able to determine whether and at what cost the assignor may obtain credit and, on that basis, to decide whether to extend credit to the debtor and on what terms. As a result of this approach to the relevant time for determining internationality, however, in the case of a domestic bulk assignment of domestic and international future receivables, the parties may not be able to predict at the time of the assignment whether the draft Convention will apply (this problem would not arise, however, in the case of international assignments of domestic or international receivables, since the internationality of an assignment could be determined at the time it is made). Furthermore, in the case of a domestic assignment of both domestic and international receivables, the draft Convention would apply to the assignment of the international receivables but not to the assignment of the domestic receivables. This means that, depending on whether the draft

Convention applies, implied representations as between the assignor and the assignee, as well as the legal position of the debtor may be different (e.g. as to defences and rights set-off, but not as to discharge, since the debtor may discharge under law applicable outside the draft Convention). However, the applicable priority rules would not be different, since the draft Convention would cover in any case all possible conflicts of priority, including conflicts with a domestic assignee of domestic receivables.

40. Parties to domestic assignments will, therefore, need to structure their transactions in a certain way to avoid this problem (e.g. by avoiding to assign in one transaction both domestic and international receivables). Where parties are not able to do so, they will be exposed to the possibility that one law may apply to domestic receivables while another law, the draft Convention, would apply to international receivables. This problem, however, is not created by the draft Convention; it exists already outside the draft Convention in cases where domestic and international receivables are assigned. Furthermore, structuring a transaction under the draft Convention would be easier than under other law, at least, to the extent that parties to a domestic assignment will be faced with only two laws that may possibly apply to their assignment, the law of the country, in which the assignor and the assignee are located, and the draft Convention. In addition, a debtor's legal position would not be changed, unless the debtor is located in a Contracting State or the law governing the receivable is the law of a Contracting State.

Article 4. *Exclusions*

(1) This Convention does not apply to assignments:

(a) Made to an individual for his or her personal, family or household purposes;

(b) To the extent made by the delivery of a negotiable instrument, with any necessary endorsement;

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

[(2) This Convention does not apply to assignments listed in a declaration made under article 39 by the State in which the assignor is located, or with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, by the State in which the debtor is located.]

References:

A/CN.9/432, paras. 18, 47-52, 106 and 234-238
A/CN.9/434, paras. 42-61
A/CN.9/445, paras. 168-179
A/CN.9/456, paras. 46-52
A/CN.9/466, paras. 54-59, 78-86 and 192-195

Commentary

41. In view of the broad scope of application of the draft Convention, article 4 is intended to exclude certain practices that are either distinct from assignment-related practices or are already sufficiently regulated.

Assignments for consumer purposes

42. Subparagraph *(a)* is intended to exclude from the scope of the draft Convention assignments from a business entity or a consumer to a consumer but only if they are made for the assignee's personal, family or household purposes. The Working Group agreed that such assignments were of no practical significance. As a result, assignments of consumer receivables were not excluded, unless made to a consumer for his/her consumer purposes.

Assignments of negotiable instruments

43. Subparagraph *(b)* is intended to exclude transfers of negotiable instruments. Such transfers are distinct from assignments and are regulated by specific rules of national and international law (e.g. there is no requirement for the notification of a transfer; if the debtor pays a transferee who is not the holder, the debtor is still liable to the holder; a person who takes the instrument for value and without knowledge of any hidden defences against the transferor is not subject to those defences). Rather than referring to the documentary nature of a receivable, subparagraph *(b)* focuses on the form of the transfer. Such an approach is sufficient to preserve the negotiability of an instrument, while it avoids the need to define "negotiable instrument", a term on which there is no universal understanding. Excluded are transfers of receivables made by endorsement and delivery or by mere delivery of an instrument. Such instruments include bills of exchange, promissory notes, cheques and bearer documents (e.g. negotiable securities).

44. Receivables arising under a contract are often incorporated into a negotiable instrument for the sole purpose of obtaining payment by way of summary proceedings in court, if necessary. In such cases, both the receivable arising under a contract and the receivable incorporated into a negotiable instrument may be transferred. The words "to the extent made by the delivery ... with any necessary endorsement" are intended to ensure that only the transfer of the receivable in the form of a negotiable instrument and not of the receivable in its contractual form is excluded from the scope of application of the draft Convention. The Commission may wish to consider whether article 4 *(b)* should refer to transfers of dematerialized (i.e. electronic) negotiable instruments.

Assignments of receivables in corporate buyouts

45. Subparagraph *(c)* is aimed at excluding assignments made in the context of the sale of a business as a going concern, if they are made from the seller to the buyer. Such assignments are excluded since they are normally regulated differently by national laws dealing with corporate buyouts and are not of a financing nature. However, assignments made to an institution financing the sale are not excluded.

Other types of assignments or receivables

46. In the course of its work, the Working Group considered the exclusion of other types of assignments, such as assignments by operation of law, assignments as gifts, assignments of wages, contractual rights in general, insurance premiums, rights under independent guarantees and letters of credit ("independent undertakings"), assignments of

rents from real estate and equipment and assignments of balances in deposit accounts. As to assignments by operation of law, it should be noted that they are excluded in view of the definition of "assignment" by reference to a "transfer by agreement" (article 2 *(a)*). In view of the fact that consideration was thought to be part of the contract of assignment, which, with the exception of articles 13 to 16 and 28, is not addressed in the draft Convention, the Working Group decided not to address assignments as gifts.

47. As to the assignment of wages (or pensions), the Working Group decided to leave the matter to other law. If such assignments are prohibited under national law, the draft Convention does not affect that prohibition. If, however, such assignments are not prohibited under national law, with a view to preserving significant practices, such as the financing of temporary employment services, the draft Convention does not do anything to invalidate them. However, that result may not be achieved, unless a specific reference to statutory limitations relating to personal or similar receivables is included in article 9, which validates assignments of future receivables, without any exception as to personal rights that may not be assignable under national law (on this matter, see also paras. 84 and 85).

48. The assignment of the right to present an independent undertaking along with any documents it requires and demand payment is not intended to be covered by the draft Convention (the Commission may wish to state this result explicitly in article 4). However, the assignment of the proceeds of payment of an independent undertaking is covered by the draft Convention, with the additional protection introduced in article 5 for the guarantor/issuer of such an independent undertaking. As to the assignment of receivables arising from the sale or lease of mobile equipment, the Working Group decided that it should not be excluded. Article 36 was thought to be sufficient to address any conflicts with a preliminary draft Convention currently being prepared (see para. 211; as to the assignment of receivables other than trade receivables, see paras. 50-54). In order to reduce the potential for such conflicts, the Commission may wish to consider whether the assignment of receivables arising from the sale or lease of high-value mobile equipment should be treated in the same way as assignments of receivables other than trade receivables (i.e. whether contractual limitations on assignment need to be given effect to the extent of invalidating the assignment in general or only as against the debtor). Article 12 (5) would be sufficient to preserve any form or registration requirements relating to security and other supporting rights in high-value mobile equipment and article 24 would be sufficient to ensure that any conflicts of priority would be subject to the preliminary draft Convention if the assignor is located in a State party to the preliminary draft Convention.

49. In the interest of enhancing the acceptability of the draft Convention, paragraph (2), which appears within square brackets since it has not been adopted yet by the Working Group, is intended to ensure that States are given the option to exclude further practices. Such an approach may be necessary if no agreement is reached on the practices to be excluded in paragraph (1) or in order to address concerns that might arise in the future. However, a possible disadvantage of such an approach would be that the scope of the draft Convention could vary from State to State, with the result that, in view of the multiplicity of parties involved and the possibility that one or more but not all potentially relevant States might have made a declaration, the exact scope of the draft Convention would not be easy to ascertain.

[Article 5. *Limitations on [assignments of] receivables other than trade receivables*

Variant A

(1) Articles 17, 18, 19, 20 and 22 do not affect the rights and obligations of the debtor in respect of a receivable other than a trade receivable except to the extent the debtor consents.

(2) Notwithstanding articles 11 (2) and 12 (3), an assignor who assigns a receivable other than a trade receivable is not liable to the debtor for breach of a limitation on assignment described in articles 11 (1) and 12 (2), and the breach shall have no effect.

Variant B

Articles 11 and 12 and section II of chapter IV apply only to assignments of trade receivables. With respect to assignments of receivables other than trade receivables, the matters addressed by these articles are to be settled in conformity with the law applicable by virtue of the rules of private international law.]

Reference:

A/CN.9/466, paras. 60-77

Commentary

50. Article 5, which appears within square brackets since it has not been adopted by the Working Group, is intended to address special needs of practices involving, for example, swaps and derivatives, repos, receivables in clearing-house transactions, deposit accounts, securities accounts, as well as insurance receivables and receivables arising from independent undertakings. In those practices, it is essential to ensure that the position of the debtor is not changed as a result of an assignment, without the debtor's consent (i.e. that the debtor may ignore any notification, discharge its debt as stipulated in the original contract, retain all its defences and rights of set-off, as well as the right to amend the original contract without the consent of the assignee).

51. With regard to swaps and derivatives in particular, the approach of article 5 appears to be justified by the fact that, in such financial transactions, it is inherent that any party may be debtor or creditor and, by definition, payments net against each other. As a result, if one payment is pulled out, the whole transaction may be unravelled. In other words, an assignment may increase the credit risk on the basis of which a party entered into the transaction. In view of the importance of such transactions for international financial markets and their volume, such a situation may create a systemic risk that may affect the financial system as a whole. The same two-way flow of payments and the need to preserve the

mutual character of payments may exist with regard to clearing-house transactions. As to repos, it would need to be ensured that a party does not find its obligation to pay assigned to and pursued by another party while the original counter-party refuses to return the security.

52. As to other types of receivables (assignments of balances in deposit accounts, insurance receivables and proceeds of independent undertakings), an article 5 approach may be required for different reasons. With regard to independent undertakings, for example, there is a need to avoid upsetting well established practices or contradicting the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, New York, 1995 ("the Guarantee and Standby Convention")). Articles 11 (1) and 12 (2) would contradict article 10 of the Guarantee and Standby Convention, under which the beneficiary may not assign any proceeds without the consent of the guarantor/issuer. As to deposit accounts and securities accounts, it is essential to ensure that rights of set-off of the depositary institution or the securities broker are not affected.

53. In both variants A and B, receivables are defined by reference to the well-known notion of "trade receivable". This approach has the advantage that it avoids the need to define the term "financial receivable", a term that is not universally understood in the same way and whose meaning keeps changing with the creation of new practices. On the other hand, by referring to any receivable other than a trade receivable, article 5 may inadvertently result in excluding transactions that should not be excluded. The Commission may, therefore, wish to define the excluded practices in a more specific way. The main difference between variants A and B lies in the fact that, under variant A, the assignment may be valid as between the assignor and the assignee and only its effects as against the debtor are left to law applicable outside the draft Convention, while, under variant B, the validity and effectiveness of an assignment altogether is left to law applicable outside the draft Convention. Another difference is that, unlike variant B, variant A gives the debtor the right to consent to the application of the draft Convention to the debtor's rights and obligations. Yet another difference between variants A and B is that, under variant A, the debtor would not have the right to terminate the original contract for breach of a contractual limitation on assignment.

54. The value of preserving the validity of the assignment as between the assignor and the assignee lies in the fact that such validity is a condition for obtaining priority. If the debtor pays the assignor, the assignee has a property claim in the assigned receivable. Such an approach is intended to facilitate practices in which the assignor receives payments on behalf of the assignee and holds the proceeds separate from its other assets (e.g, securitization or undisclosed invoice discounting). In addition, such an approach is intended to preserve for assignors, assignees, third-party creditors and consenting debtors, in practices involving the assignment of financial receivables, or of both trade and financial receivables, the main benefits of the draft Convention, which cannot be ensured by way of contract as they are normally part of mandatory law (e.g. the validity of assignments of future receivables and of bulk assignments, as well as the priority rules of the draft Convention).

CHAPTER II. GENERAL PROVISIONS

Article 6. *Definitions and rules of interpretation*

For the purposes of this Convention:

(a) "Original contract" means the contract between the assignor and the debtor from which the assigned receivable arises;

(b) "Existing receivable" means a receivable that arises upon or before the conclusion of the contract of assignment; "future receivable" means a receivable that arises after the conclusion of the contract of assignment;

[*(c)* "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;]

(d) "Writing" means any form of information that is accessible so as to be usable for subsequent reference. Where this Convention requires a writing to be signed, that requirement is met if, by generally accepted means or a procedure agreed to by the person whose signature is required, the writing identifies that person and indicates that person's approval of the information contained in the writing;

(e) "Notification of the assignment" means a communication in writing which reasonably identifies the assigned receivables and the assignee;

(f) "Insolvency administrator" means a person or body, including one appointed on an interim basis, authorized in an insolvency proceeding to administer the reorganization or liquidation of the assignor's assets or affairs;

(g) "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 or other competent authority for the purpose of reorganization or liquidation;

(h) "Priority" means the right of a party in preference to another party;

(i) A person is located in the State in which it has its place of business. If the assignor or the assignee has more than one place of business, the place of business is that place where its central administration is exercised. If the debtor has more than one place of business, the place of business is that which has the closest relationship to the original contract. If a person does not have a place of business, reference is to be made to the habitual residence of that person;

(j) "Law" means the law in force in a State other than its rules of private international law;

(k) "Proceeds" means whatever is received in respect of an assigned receivable, whether in total or partial payment or other satisfaction of the receivable. The term includes whatever is received in respect of proceeds. The term does not include returned goods;

[*(l)* "Trade receivable" means a receivable arising under an original contract for the sale or lease of goods or the provision of services other than financial services.]

References:

A/CN.9/420, paras. 52-60
A/CN.9/432, paras. 70-72, 94-105
A/CN.9/434, paras. 78-85, 109-114, 167 and 244
A/CN.9/445, paras. 180-190
A/CN.9/456, paras. 53-78
A/CN.9/466, paras. 25-31, 46-49 and 94-100

Commentary

"Original contract"

55. The original contract, which is used as a point of reference in articles 6 *(i)*, 17, 18 (1), 19 (1), 20 (1), 22 (2) *(b)* and 23, is the source of the assigned receivable. With the exception of those provisions which expressly state otherwise (e.g. articles 9-12 and 17-23), the draft Convention is not intended to affect the original contract.

"Existing" and "future" receivable

56. The terms "existing" and "future" receivable are referred to in articles 9 (effectiveness of an assignment) and 10 (time of assignment). The distinction between an existing and a future receivable is based on the time of the conclusion of the original contract. A receivable arising under a contract, which has been concluded before or at the time of assignment, is considered to be an existing receivable, even though it does not become due until a future date or is dependent upon counter-performance or some other stated event. The definition covers the entire range of future receivables, including conditional receivables (i.e. receivables that might arise subject to a future event that may or may not take place) and purely hypothetical receivables (i.e. receivables that might arise from an activity not initiated by the assignor at the time of the assignment; for a limitation introduced in article 9, see para. 89). The exact meaning of the term "conclusion of the contract" is left to law applicable outside the draft Convention. In any case, "conclusion" is not intended to refer to the performance of the contract.

"Receivables financing"

57. The term appears within square brackets in the preamble and in article 13 (3). The Commission may wish to delete this definition and, possibly, to refer to receivables financing only in the preamble (see para. 5).

"Writing"

58. The term is referred to in articles 6 *(e)*, 19 (1) and (5), 21 (1) and (3), 41 (2) and (4), 44 (1) of the draft Convention and in article 5 of the annex. Its definition is intended to include other than paper-based means of communications that can perform the same functions as a paper communication (e.g. provide tangible evidence, serve as a warning to the parties with regard to the consequences or provide a legible communication, authentication and sufficient assurances as to its integrity). It is inspired by articles 6 and 7 of the UNCITRAL Model Law on Electronic Commerce and reflects the two distinct notions of "writing" and "signature".

59. On the assumption that the need for higher assurances as to the authenticity of communications should be assessed differently depending on the context in which the communication is made, the draft Convention requires a writing for the notification of the assignment and a writing signed by the debtor for the waiver of the debtor's defences. Writing is also required for declarations by States and for certain registration-related acts. "Accessible" is meant to imply that the communication is readable and interpretable; "usable" refers not only to use by a physical person but also by a computer; and "subsequent reference" establishes a standard that is akin to that implied by a notion such as durability (while not referring to the strict interpretation given to the notion of durability in certain legal systems as equivalent to non-alterability) but more objective than that implied by notions such as readability or intelligibility (see Guide to Enactment of the Model Law, para. 50). Signature is defined by reference to the identification of the signer and indication of the signer's approval of the content of the communication.

"Notification of the assignment"

60. The term is used in articles 15, 16, 18, 19, 20 (2) and 22. A notification meets the requirements of the draft Convention if it is in writing and reasonably identifies the assigned receivables and the assignee. If a notification does not meet those requirements, it is not effective under the draft Convention (i.e. it does not trigger a change in the way in which the debtor may discharge its obligation or does not affect the debtor's rights of set-off or the debtor's right to modify the original contract in agreement with the assignor). However, the question whether such a notification is valid under law applicable outside the draft Convention is subject to that law. In particular, if pursuant to such a non-conforming notification the debtor pays the person entitled to payment (whether under the draft Convention or other applicable law), under article 19 (6), the debtor is discharged (see para. 142).

61. What is a reasonable description in each particular case is a matter to be determined in view of the circumstances. In general, it would not be necessary to state whether an outright assignment or an assignment by way of security is involved or to specifically identify the debtor or the amount. A general identification along the lines "all my receivables from my car business to X" or "all my receivables as against my clients in countries A, B and C to Y" would be reasonable. However, in the case of a partial assignment, the amount assigned may need to be specified in the notification (on partial assignments, see paras. 32-34 and 91). Furthermore, while the notification must reasonably identify the assignee for it to be an effective notification under the draft Convention, it does not need to identify the payee (i.e. the person to whom or for whose account or the address to which the debtor is to pay). As a result, a notification containing no payment instruction is effective under the draft Convention (article 19 (2)). However, in view of the fact that, under the draft Convention, a notification changes the way in which the debtor may discharge its debt, parties notifying the debtor would be encouraged to include in their notification such a payment instruction. The Working Group based the discharge of the debtor on

the notification rather than on the payment instruction in order to avoid confusing the debtor in cases where the two communications might be sent separately or in which several communications might be sent to the debtor by several persons.

"Insolvency administrator" and "insolvency proceeding"

62. The term "insolvency administrator" is used in articles 24 *(a)* (iii) and 30 (1) *(a)* (iii) of the draft Convention and articles 2 and 7 of the annex. The term "insolvency proceeding" is used in article 25 of the draft Convention and articles 2 and 7 of the Annex. Their definitions have been inspired by the definitions of "foreign proceeding" and "foreign administrator" contained in article 2 *(a)* and *(d)* of the UNCITRAL Model Law on Cross-Border Insolvency. They are also consistent with articles 1 (1) and 2 *(a)* and *(b)* of the European Union draft Regulation on Insolvency Proceedings. By referring to the purpose of a proceeding or to the function of a person, rather than using technical expressions that may have different meanings in different legal systems, the definitions are sufficiently broad to encompass a wide range of insolvency proceedings, including interim proceedings. This approach is intended to avoid a Contracting State recognizing as an insolvency proceeding or administrator a proceeding or person who does not have that character under the lex loci concursus or is unable to recognize as an insolvency proceeding or administrator a proceeding or person who has that character under the lex loci concursus.

"Priority"

63. The term "priority" is used in articles 16, 24, 25 (2), 26, 27, 30 and 40 of the draft Convention, as well as in articles 1, 2, 6 and 7 of the annex. Priority under the draft Convention means that a party may satisfy its claim in preference to other claimants. Priority does not mean validity (in the draft Convention, the term "effectiveness" is used instead, to denote the proprietary effects of the assignment). It presupposes a valid assignment (substantive or material validity is dealt with in chapter III, while formal validity is left to law applicable outside the draft Convention; for a secretariat suggestion to deal with the law applicable to formal validity, see paras. 80-82).

64. In addition, priority does not mean that a claimant has a proprietary (in rem) rather than a personal right (ad personam) with respect to the assigned receivable or any proceeds. This matter is left to the law of the assignor's location (articles 24 and 26). Moreover, priority does not prejudge the issue of whether the assignee with priority will retain all the proceeds of payment or turn over any remaining balance to the assignor or to the next claimant in the order of priority. This matter depends on whether an outright assignment or an assignment by way of security is involved, a matter left to law applicable outside the draft Convention (article 24). Priority does not affect the discharge of the debtor either. The debtor paying in accordance with article 19 (or, if article 19 is not applicable, in accordance with the law applicable under article 29) is discharged, even if payment is made to an assignee who does not have priority (under article 24 or, if article 24 is not applicable, under article 30). Whether that assignee will retain the proceeds of payment is a matter of priority to be resolved among the various claimants in accordance with the law applicable under article 24 (or article 30).

65. The definition does not refer to the right to payment since, while this expression might be appropriate for assignments by way of security, it might be restrictive in outright assignments in which the assignee may, for example, have a right to receive any goods returned by the debtor to the assignor. After the Working Group's decision to exclude returned goods from the definition of proceeds for the purposes of the priority rules of the draft Convention, the Commission may wish to revise the definition of priority to refer to a right to payment. The Commission may also wish to consider whether the combined application of articles 6 *(h)*, 9 and 24 *(a)* (i) is sufficient to ensure that more than one assignment of the same receivables by the same assignor may be effective. This result is assumed in article 24 *(a)* (i), which refers to a conflict of priority between several assignees of the same receivables assigned by the same assignor. However, in some legal systems, this matter does not raise a question of priority at all but one of effectiveness (nemo dat quod non habet). As a result, in such jurisdictions, the first assignment may be considered effective under article 9 and any subsequent assignment ineffective under national law, for lack of title (a matter not addressed in article 9, dealing with the proprietary effects of assignment, although addressed in article 14, dealing with the contract of assignment). In such cases, article 24 may never come into play.

"Location"

66. This term is referred to in several provisions of the draft Convention (i.e. articles 1 (1) *(a)* and (2), 3, 4 (2), 17 (2), 21 (1), 23, 24, 25, 30, 35 (3), 36, 37 and 39). The two main subjects, however, in which the term "location" is referred to, are the scope of application and questions of priority. The definition is intended to strike a balance between flexibility and certainty. The place of business is a well-known term, widely used in UNCITRAL and other international legislative texts, and on which abundant case law exists. It is used to denote a place in which the professional activities of a person or an entity are conducted. For the purpose of the application of the law of a State, several places of business in one and the same State are considered one place of business. In order to ensure a sufficient degree of predictability of the application of the draft Convention with regard to the debtor, in the case of multiple places of business of the debtor, reference is made to the place with the closest connection to the original contract. On the other hand, with a view to ensuring that priority issues are referred to a single jurisdiction (and one in which any main insolvency proceeding is most likely to be opened), article 6 *(i)* provides that, if the assignor (or the assignee) has more than one place of business, "place of business" means the place of central administration. The rule contained in article 6 *(i)* is applied throughout the draft Convention in order to avoid defining "place of business" differently for different purposes. Such an approach could complicate the application of the draft Convention or even lead to inconsistent results.

67. Place of central administration is akin to the centre of main interests (a term used in the UNCITRAL Model Law on Cross-Border Insolvency), chief executive office or principal place of business. All those terms are understood as denoting the centre of management and control, the real business centre, from which in fact, not as a matter of form, the important activities of an entity are controlled and ultimate decisions at the highest level are actually made (without regard to the place where most assets are located or books and records are kept), rather than the day-to-day management of the affairs and operations of such an entity. However, unlike the UNCITRAL Model Law, in which a rebuttable presumption is established that the centre of main interests is the place of registration (article 16 (3)), the draft Convention does not introduce such a "safe harbour" rule. The reason for this approach is that, unlike the UNCITRAL Model Law whose main focus is on insolvency, the draft Convention focuses mainly on the advance planning in the financing of a solvent debtor and for that planning to be facilitated it is absolutely necessary to define location by reference to a single and easily determinable jurisdiction.

68. In most cases, the place of central administration would be easy to determine. However, the place of central administration may not be as transparent as the place of incorporation (formal location), for example, where the place of exercise of central authority is so evenly divided between two or more countries as to make the choice of one over the other impossible or in the case of subsidiary companies where the real administrative control resides in the parent company. However, the place of incorporation presents the disadvantage that it is not a notion known in many legal systems and that its use would raise the problem of the application of the law of a jurisdiction without a close connection to the contract of assignment, which may not have any developed laws. Referring to place of central administration and creating a rebuttable presumption in favour of the place of incorporation could provide a solution to this problem, but it would inadvertently result in reducing the level of certainty achieved by a place-of-central-administration location rule (since there may be more than one place of registration). In any case, in the exceptional situations in which the place of central administration did not readily point to a single jurisdiction, parties would be left in no worse situation than they were to begin with and would endeavour to ensure that their interest was effective and enforceable in each jurisdiction in which the assignor might possibly be located.

69. The definition of "location" does not address the problem of subjecting transactions of branch offices to the law of the head office (in particular priority issues, which may arise in cases where the same receivables are assigned by one or more branch offices and the head office, or by different branch offices to different assignees). In order to address that problem, the Working Group, at its thirty-first session, considered an exception for branch offices in the banking industry only or in other industries as well, but was not able to reach consensus (see A/CN.9/466, paras. 25-30, 96 and 97). At the end of the thirty-first session, a suggestion was made with respect to branch offices of financial service providers, which the Working Group, for lack of sufficient time, was not able to consider (see A/CN.9/466, paras. 98 and 99). The justification for such a limited exception is that financing institutions tend to do business abroad through branch offices so that they are able to draw on their capital as a whole (and not only the capital deposited, e.g. for the business of a separate entity, a subsidiary) and their branch offices tend to be subject to the law of the State in which they do business.

70. Under the proposed text, in the case of a branch of a financial service provider with more than one place of business, "place of business" of the assignor and the assignee means the place where the branch on whose books a receivable is carried immediately prior to the assignment is located. "Financial service provider" is defined by reference to a "bank or other financial institution" (e.g. a securities dealer) and "deposits, loans or other financial services". The exact meaning of those terms is left to law outside the draft Convention. "Branch" is defined by reference to a place of business other than the place of central administration. The words "is carried on the books" are defined by reference to "[accounting] [regulatory] standards", the exact meaning of which is also left to law outside the draft Convention. If an exception is introduced to the location rule with respect to branch offices of financial institutions, it would need to be made also with respect to other industries in which a branch-based structure is used (e.g. the insurance industry). The broader the exception is, the more the appropriateness of the central administration rule is put into doubt. In its deliberations on the issue of "location" of branch offices, the Commission may wish to take into account article 1 (3) of the UNCITRAL Model Law on International Credit Transfers ("for the purpose of determining the sphere of application of this law, branches and separate offices of a bank in different States are separate banks"). The Commission may wish to consider the placement of article 6 *(i)* in the text of the draft Convention (see para. 13).

"Law"

71. The term "law" appears in the preamble and in articles 1 (2), 5, variant B, 8 (2), 12 (1), (4) and (5), 21, 23 to 25, 28 to 32, 35 and 40 (2). The definition of "law" is intended to ensure that renvoi is avoided. If "law" included private international law provisions, any matter could be referred to a law other than the law applicable by virtue of the private international law provisions of the draft Convention. Such a result would defeat the certainty of applicable law sought by the private international law provisions of the draft Convention. The Commission may wish to define "law" for the case of a federal State with more than one legal system (for the application of the draft Convention in the case of a federal State, 202). Language along the following lines may be considered: "In the case of a State with two or more territorial units in which different systems of law are applicable in relation to matters dealt with in this Convention, 'law' means the law of the territorial unit identified in the rules in force in such a State identifying which territorial unit's law is applicable. In the absence of such rules, 'law' means the law of the territorial unit with the relevant connection". The Commission may also wish to consider whether any other federal-State interpretation clause would be necessary (e.g. with respect to the meaning of "location").

"Proceeds"

72. The term "proceeds" appears in articles 12 (1), 16 (1), 24 *(b)* and 26. Its definition is intended to cover both proceeds of receivables and proceeds of proceeds (e.g. if the receivable is paid by way of a cheque, the cheque is "proceeds of the receivable" and cash received by the payee of the cheque is "proceeds of proceeds"). It is also intended to cover, proceeds in cash ("payment") and proceeds in kind ("other satisfaction"), whether received in total or partial satisfaction of the assigned receivable. In particular, it is intended to cover goods received in total or partial discharge of the assigned receivable but not returned goods (e.g. because they were defective and the sales contract was cancelled or because the sales contract allowed the buyer to return the goods after a trial period). However, as between the assignor and the assignee, the assignee has a right in returned goods (see para. 126).

"Trade receivable"

73. The definition of "trade receivable", a term that appears in article 5, is in line with the general understanding with regard to this term as codified in the Ottawa Convention. Unlike the Ottawa Convention, however, subparagraph *(l)* excludes receivables arising from financial services.

Article 7. *Party autonomy*

The assignor, the assignee and the debtor may derogate from or vary by agreement provisions of this Convention relating to their respective rights and obligations. Such an agreement does not affect the rights of any person who is not a party to the agreement.

References:

A/CN.9/432, paras. 33-38
A/CN.9/434, paras. 35-41
A/CN.9/445, paras. 191-194
A/CN.9/456, paras. 79 and 80

Commentary

74. Article 7, which is modelled on article 6 of the United Nations Convention on Contracts for the International Sale of Goods, Vienna, 1980 ("the United Nations Sales Convention"), provides broad recognition of the principle of party autonomy. The assignor, the assignee and the debtor may vary or derogate from the provisions of the draft Convention. Unlike article 6 of the United Nations Sales Convention, however, article 7 does not allow parties to vary, or derogate from, provisions that affect the legal position of third parties, or to exclude the draft Convention as a whole. Accordingly, the assignor and the assignee may only vary or derogate from articles 13 to 16 and 28, while the assignor and the debtor are free to vary or derogate from articles 17 to 23, as long as the rights of third parties are not prejudiced. The reason for this different approach is that, while the United Nations Sales Convention deals with the mutual rights and obligations of the seller and the buyer, the draft Convention deals mainly with the proprietary effects of assignment and may, therefore, have an impact on the legal position of the debtor and other third parties. Allowing parties to an agreement to affect the rights and obligations of third parties would not only go beyond any acceptable notion of party autonomy but would also introduce an undesirable degree of uncertainty and could thus frustrate the main objectives of the draft Convention, that is, to facilitate increased access to lower-cost credit and to provide, at the same time, an adequate debtor protection system.

75. Like article 6 of the United Nations Sales Convention, article 7 requires an agreement, that is two corresponding declarations of intent, for the effective derogation from the draft Convention. Such an agreement may be explicit or implicit. A typical example of an implicit derogation is where the parties refer to the law of a non-Contracting State or to the domestic law of a Contracting State. Article 7 is intended to apply to an agreement between the assignor and the assignee ("third parties" are the debtor, the creditors of the assignor and the insolvency administrator) and to an agreement between the assignor and the debtor ("third parties" are the assignee, the assignor's creditors and the insolvency administrator). The Commission may wish to clarify whether article 7 should apply also to an agreement between the assignee and the debtor (e.g. an agreement whereby the debtor would waive its defences as against the assignee in return for a concession, such as a reduction of the interest rate or extension of the date of payment. Such agreements are not covered and, therefore, not limited by article 21 (see para. 150).

Article 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.

References:

A/CN.9/432, paras. 76-81
A/CN.9/434, paras. 100 and 101
A/CN.9/445, paras. 199 and 200
A/CN.9/456, paras. 82-85

Commentary

76. Article 8, inspired by article 7 of the United Nations Sales Convention, deals with the interpretation of and the filling of gaps in the draft Convention. With regard to the interpretation of the draft Convention, article 8 (1) refers to three principles, namely, the international character of the text, uniformity and good faith in international trade. These

principles are common to most UNCITRAL texts. The reference to the international character or source of the text should lead a court to avoiding interpretation of the draft Convention on the basis of notions of national law, unless the meaning of a term used in the draft Convention is clearly identical with its meaning under a particular national law or is clearly left to law applicable outside the draft Convention. The need to preserve uniformity can be served only if courts or arbitral tribunals apply the draft Convention on its merits and have regard to decisions of courts or tribunals in other countries. The Case Law on UNCITRAL Texts (CLOUT), a system of reporting case law on UNCITRAL texts, has been established by UNCITRAL exactly with the need to preserve uniformity in mind. CLOUT is available in paper form in the six official languages of the United Nations and through the UNCITRAL home page on the World Wide Web (http:\\www.uncitral.org) in English, French and Spanish (depending on the resources available, the other language versions will also be made available in the future).

77. The reference to good faith relates only to the interpretation of the draft Convention. If as a result of a contra legem interpretation it is applied to the conduct of the parties, caution should be exercised. While the principle of good faith would appropriately be applied to the contractual relationship between the assignor and the assignee, or the assignor and the debtor, it could undermine the certainty of the draft Convention if applied to the relationship between the assignee and the debtor or the assignee and any other claimant. For example, if the principle of good faith prevailing in the forum State were to apply to the assignee-debtor or the assignee-third party relationship, the debtor, who might have paid the assignee after notification, may have to pay again if, for example, the debtor knew about a previous assignment; and the law applicable under article 24 might be disregarded if it does not respect the principle of good faith as it may be understood in the forum State.

78. As to gap-filling, the rule is that, if matters fall within the scope of the draft Convention under chapter I but are not expressly settled in it, they are to be decided in accordance with the general principles on which the draft Convention is based. Such principles include notably the principles expressly mentioned in the preamble or enshrined in a number of provisions of the draft Convention (e.g. the principle of facilitation of increased access to lower-cost credit and the principle of debtor protection). Recourse to private international law rules is permitted only if, with respect to a matter governed by, but not explicitly settled in, the draft Convention, there is no principle on the basis of which it could be resolved or the matter is not governed by the draft Convention at all. Gaps left in the private international law provisions of the draft Convention are to be filled in accordance with the private international law principles underlying the draft Convention. In the absence of such principles, such gaps would be filled in accordance with the private international law rules of the forum.

79. Matters not governed by the draft Convention and left to law applicable outside the draft Convention by virtue of private international law rules include, but are not limited to, the requirements and the legal consequences of an outright assignment, an outright assignment for security purposes and an assignment by way of security; the question of the form of the contract of assignment; the accessory or independent character of a security right, which is the basis for determining whether it is transferred automatically with the receivables the payment of which it secures, or whether a new act of transfer is needed; and the consequences of a breach of representations by the assignor. The draft Convention covers statutory assignability to the extent that it specifies a number of receivables that are assignable, including future receivables and receivables not identified individually, but leaves other statutory limitations (relating, e.g. to pensions or wages) to other law. Matters left to law applicable outside the draft Convention also include: the question whether the assignor is liable towards the debtor for assigning trade receivables in violation of an anti-assignment clause; the debtor's obligation to pay (the draft Convention deals with the debtor's discharge only); the discharge of the debtor on grounds other than those specified in the draft Convention (e.g. by paying the rightful claimant if the notification received does not meet the requirements of the draft Convention); the defences and rights of set-off that the debtor may raise against the assignee; and agreements between the debtor and the assignee by which the debtor waives its defences and rights of set-off towards the assignee. Beyond those matters, the draft Convention explicitly refers certain matters (e.g. questions of priority) to law applicable outside the draft Convention, while specifying that law. Whether the law applicable to all the matters mentioned above, as well as to other matters not governed by the draft Convention, is to be determined on the basis of the private international law provisions of the draft Convention or of the forum, depends on whether the forum is in a Contracting State and on whether that Contracting State has opted out of chapter V.

CHAPTER III. EFFECTS OF ASSIGNMENT

Form of assignment

References:

A/CN.9/420, paras. 75-79
A/CN.9/432, paras. 82-86
A/CN.9/434, paras. 102-106
A/CN.9/445, paras. 204-210
A/CN.9/456, paras. 86-92
A/CN.9/466, paras. 101-103

Commentary

80. Chapter III settles issues of material validity of an assignment under the draft Convention. However, not all matters relating to material validity are settled in the draft Convention. Matters that are not addressed and are left to law outside the draft Convention include, for example, statutory limitations on assignment, other than those dealt with in articles 9, 11 and 12, and issues relating to capacity and authority. Matters of formal validity (e.g. whether writing, notification, registration or payment of a stamp duty is required for an assignment to be valid/effective) are

not dealt with at all in the draft Convention. The Working Group considered a wide variety of form requirements, ranging from written form (with or without any signature requirements) to the absence of any form. The widely prevailing view was that written form should be required for the assignment to be effective, at least as against third parties. However, in order to avoid invalidating oral practices in some countries, the Working Group decided to avoid introducing a written form requirement. The Working Group also considered the question of the law applicable to form, but was not able to reach consensus. The difficulty in dealing with form lies in the fact that form is designed to perform various functions. As between parties, a form requirement may function as a warning to the assignor with regard to the seriousness of the undertaking or as evidence minimizing the risk of disputes. As against third parties, in particular third-party creditors, a form requirement is designed to operate as a protection against the risk of fraudulent collusion in oral assignments (e.g. collusive ante-dating of an assignment or collusion as to the scope of the receivables intended to be assigned).

81. However, failing to address the issue of form in the draft Convention will create uncertainty. The absence of any rule on form may be interpreted by users of the draft Convention in different ways. It may either result in referring issues of form to law applicable outside the draft Convention or in validating any assignment irrespective of form. In the former case, uncertainty will arise with regard to the formal validity of an assignment under the draft Convention, which is a requirement of priority (as to the meaning of "priority", see paras. 63-65; this is reinforced by the fact that, unlike article 24 *(b)*, article 24 *(a)* does not deal with "existence" of a right; see paras. 165 and 170). In the latter case, the assignor, in return for a concession granted by an assignee, in particular before commencement of insolvency, may be able to grant priority to that assignee by ante-dating or enlarging the scope of the assignment. The Commission may, therefore, wish to reconsider the issue of form. A substantive law rule would be preferable. However, it would seem that it would not be feasible to achieve consensus on such a rule. Therefore, a private international law approach may be considered.

82. The Commission may wish to consider the following alternatives: either introduce a flexible rule in line with current practice in private international law with regard to formal validity of the contract between the assignor and the assignee (the proper law of the contract, the law of the country where the contract is concluded or, in the case of contracts between persons in different countries, the law of one of those countries; see article 9 of the Rome Convention or article 13 of the Mexico City Convention), combining this rule with a different rule with regard to effects as against third parties (the law of the assignor's location); or establish a "safe harbour" rule along the following lines: "An assignment is effective as against third parties if it meets, *at least*, the form requirements of the law of the State in which the assignor is located" (for a special rule in the case of a receivable supported by a security right, see para. 108). A rule referring form as against third parties to the law of the assignor's location would not necessarily run counter to current practice in private international law, since such practice relates to the contract of assignment, not to the proprietary transfer itself, and form requirements for an assignment to be in writing, notified to the debtor or registered, are intended to provide a temporal link for competing claims and thus touch upon issues of priority. In any case, a "safe harbour" rule would allow third parties to determine the formal effectiveness of an assignment as a basis for priority and would be in line with the approach followed in article 24, without interfering with prevailing trends in private international law.

Article 9. *Effectiveness of bulk assignments, assignments of future receivables and partial assignments*

(1) An assignment of existing or future, one or more, receivables and parts of, or undivided interests in, receivables is effective, whether the receivables are described:

(a) Individually as receivables to which the assignment relates; or

(b) In any other manner, provided that they can, at the time of the assignment, or, in the case of future receivables, at the time of the conclusion of the original contract, be identified as receivables to which the assignment relates.

(2) Unless otherwise agreed, an assignment of one or more future receivables is effective at the time of the conclusion of the original contract without a new act of transfer being required to assign each receivable.

References:

A/CN.9/420, paras. 45-60
A/CN.9/432, paras. 93-112 and 254-258
A/CN.9/434, paras. 122 and 124-127
A/CN.9/445, paras. 211-214
A/CN.9/456, paras. 93-97

Commentary

83. Assignments of future receivables, bulk assignments and assignments of parts of or undivided interests in receivables are at the heart of significant financing practices (e.g. factoring, securitization, project financing, loan syndication and participation, swaps and derivatives). Yet their effectiveness as a matter of property law is not recognized in all legal systems. Article 9 is intended to validate such transfers of property rights in receivables.

Statutory assignability

84. In validating the assignments to which reference is made in paragraph (1), article 9 may set aside statutory prohibitions that might exist in national law with respect to such assignments. While setting aside such statutory limitations, the draft Convention is not intended to interfere with national policies. Such policies are aimed at protecting the assignor from alienating its future property and potentially depriving itself of means of subsistence. They are often articulated by means of a requirement for specificity, which may not be possible in the case of an assignment of future receivables or a bulk assignment. With a view to counterbalancing the need to validate the assignments men-

tioned in paragraph (1) and the need to protect assignors, article 9 (1) requires that the receivables be identifiable when they arise (i.e. when the original contract is concluded) as receivables to which the assignment relates. Furthermore, in order to avoid limiting the assignor's right to transfer future receivables, the draft Convention does not give priority to one creditor over another (e.g. to a global assignee over a small supplier of materials on credit with a retention of title extending to the receivables from the sale of the assignor's final products), but leaves matters of priority to national law. As to statutory limitations aimed at protecting the debtor in assignments mentioned in paragraph (1) (as, e.g. in the case of limitations relating to partial assignments), the draft Convention does not interfere with national policies underlying such limitations to the extent that the debtor needs to be located in a Contracting State and, under the draft Convention, does not have to incur any additional cost as a result of the assignment (see paras. 32-34 and 128).

85. The draft Convention is not intended to affect any other statutory limitations, whether aimed at protecting the assignor (e.g. wage claimants or owners of retirement annuities) or at protecting debtors (e.g. sovereign or consumer debtors). This matter is left to national law applicable outside the draft Convention. This result is implicit in article 11, which deals only with contractual limitations on assignment (with regard to sovereign debtors, see paras. 213 and 214; for consumer debtors, see para. 100). As a result of the fact that this result is not stated explicitly in the draft Convention, it would be a matter for interpretation whether such matters are governed by the draft Convention but not explicitly settled, in which case article 8 (2) would apply (i.e. reference would be made first to the general principles underlying the draft Convention and then to private international law rules), or not governed at all (i.e. they would be subject to the law applicable by virtue of the private international law rules of the forum). In any case, uncertainty would arise that could have a negative impact on the availability and the cost of credit. The Commission may, therefore, wish to consider whether statutory assignability should be expressly addressed in the draft Convention. This result could be achieved by a new provision on statutory limitations along the following lines: "This Convention does not affect any statutory limitations on assignment other than those referred to in article 9." Alternatively, this result could be achieved by the exclusion of certain receivables in article 4 ("personal receivables, such as wages, pensions, receivables under transactions for personal, family or household purposes and sovereign receivables, to the extent they are not assignable under the law governing those receivables").

Effectiveness

86. The term "effective" is intended to reflect the proprietary effects of an assignment (the term "valid" could not have that effect and, in any case, is not universally understood in the same way). The exact meaning of such effectiveness, that is, whether the assignee may retain any surplus and the conditions under which the assignee may seek to enforce the receivable as against the debtor or have recourse against the assignor, depends on whether an outright assignment or an assignment by way of security is involved, which is a matter left to law applicable outside the draft Convention. In any case, the assignee may claim and (if the debtor does not raise the absence of notification as a defence and pays) retain payment (the debtor may obtain a valid discharge under article 9, irrespective of whether it paid the person with priority). If the debtor pays someone else, the receivable is extinguished and the in rem or ad personam nature of the assignee's right and the priority of this right with respect to proceeds is to be determined in accordance with the law of the assignor's location (article 24 *(b)*; see paras. 165 and 170).

87. While the assignee acquires a proprietary right in the assigned receivable, the effect of such a right is limited to the relationship between the assignor and the assignee and as against the debtor. Effectiveness as against third parties touches upon issues of priority and the draft Convention treats such issues as distinct issues, subjecting them to the law of the assignor's location (article 24). As a result, article 9 should set aside a statutory limitation on the assignment of future receivables or of receivables not identified specifically, for example, but not a rule dealing with priority between competing claims (or with statutory form requirements). Furthermore, in view of this interplay between effectiveness under article 9 and priority under article 24, article 9 would not validate the first assignment in time while invalidating any further assignment of the same receivables by the same assignor or result in the assignee prevailing over an insolvency administrator on the sole ground that the assignment took place before the effective date of the insolvency proceeding, even if the receivables arose or were earned after commencement of the insolvency proceeding. In order to reflect this interplay between effectiveness as between the assignor and the assignee and as against the debtor (as a condition for priority) and effectiveness as against third parties other than the debtor (priority) and to avoid inadvertently leaving the effectiveness of the assignments referred to in paragraph (1) altogether to the law applicable to priority, the Working Group decided to delete language in article 9 that would have made article 9, as well as article 10, subject to articles 24 to 27. For the same reason, the Working Group decided to include in article 24 wording ("with the exception of ...") clarifying that certain matters, including the effectiveness of an assignment as a matter of general law, are not left to the law governing priority (see para. 163).

88. However, the distinction between effectiveness and priority, which the draft Convention draws, may not be known in the law of the assignor's location, which may express limitations on assignment by way of a rule dealing with effectiveness in general. As a result, it may not be easy to determine, for example, whether a rule of the law of the assignor's location, limiting the effectiveness of an assignment of future receivables, is a rule dealing with effectiveness inter partes or with effectiveness as against third parties (i.e. priority). The Commission may, therefore, wish to state explicitly in the chapeau of article 9 (1) that an assignment is effective " as between the assignor and the assignee and as against the debtor". The Commission may also wish to state in a new paragraph (3) that: "The effectiveness of an assignment of the receivables referred to in paragraphs (1) and (2) of this article as against third parties other than the debtor is governed by the law applicable

under article 24. However, such an assignment is not ineffective as against such third parties on the sole ground that the law of the assignor's location does not recognize its effectiveness." Such a rule would ensure that an assignment of future receivables would not be invalidated on the sole ground that it relates to future receivables, without, however, interfering with the effectiveness of such an assignment as a matter of priority between competing claimants.

"Existing or future receivables"

89. The terms are defined in article 6 *(b)* by reference to the time of the conclusion of the original contract. All future receivables are intended to be covered, including conditional receivables and purely hypothetical receivables (see para. 56). With a view to protecting the interests of the assignor, paragraph (1) introduces an element of specificity (receivables have to be identifiable at the time they arise).

"One or more"

90. The focus of the draft Convention is on the bulk assignment of a large volume of low-value receivables (e.g. factoring of trade receivables or securitization of credit card receivables) in view of their importance and practice and the fact that their effectiveness is not common ground to all legal systems. For reasons of consistency, the assignment of single, large-value receivables (e.g. the assignment of a loan for refinancing or portfolio diversification purposes) is also covered.

"Parts of or undivided interests in receivables"

91. Partial assignments are involved in significant transactions, such as securitization (in which the special purpose vehicle (SPV) may assign to investors undivided interests in the receivables purchased from their originator as security for the SPV's obligations to investors) or loan syndication and participation (in which the leading lender may assign undivided interests in the loan to a number of other lenders; for partial assignments, see paras. 32-34 and 61).

"Described"

92. The term "described" is intended to establish a standard lower than that which would be established by the term "specified". Under this standard, a generic description of the receivable, without any specification of the identity of the debtor or the amount of the receivable, would be sufficient (e.g. "all my receivables from my car business").

"Individually"/"in any other manner"

93. These words are intended to ensure that an assignment of existing and future receivables is effective, whether the receivables are described one by one or in any other manner that is sufficient to relate the receivables to the assignment.

Time of identification of receivables

94. Existing receivables are to be identified as receivables relating to the assignment at the time of the assignment. Future receivables should be identifiable at the time they arise (which is, by definition, after the time of the assignment). As a result of article 7, which enshrines party autonomy, the assignor and the assignee may agree on the time when future receivables should be identifiable to the assignment, as long as they do not affect the rights of the debtor and other third parties.

Master agreements

95. With a view to expediting the lending process and reducing the cost of the transaction, paragraph (2), in effect, provides that a master agreement is sufficient to transfer rights in a pool of future receivables. If a new document were to be required each time a new receivable arose, the costs of administering a lending programme would increase considerably and the time needed to obtain properly executed documents and to review those documents would slow down the lending process to the detriment of the assignor. Under paragraph (2), which provides that the master agreement is sufficient to transfer a pool of future receivables, and article 10, which provides that a future receivable is deemed to be transferred at the time of the conclusion of the contract of assignment, rights in future receivables are transferred directly to the assignee without passing through the estate of the assignor. As a result, the assignee would have a proprietary right and, if the assignee also has priority, its right would not be subject to the personal claims of the assignor's creditors or the insolvency administrator. In its original formulation, paragraph (2) referred to the time a future receivable "arises" with a view to clarifying that an assignment of a future receivable could be effective only if that receivable arises. In view of the deletion of the provision explaining the meaning of the word "arises", the Working Group, at its thirty-first session, decided to substitute the words "at the time of the conclusion of the original contract" for the word "arises". As a result, paragraph (2) deals with the time of assignment in a way that is inconsistent with article 10, under which the assignment of future receivables is effective at the time of the conclusion of the contract of assignment and parties may agree only on a later time. The Commission may, therefore, wish to delete the reference to the time of the conclusion of the original contract of assignment and leave the matter to the commentary on article 10 (see para. 96). Alternatively, paragraph (2) could be aligned with article 10 and refer to the time of the conclusion of the contract of assignment.

Article 10. *Time of assignment*

An existing receivable is transferred, and a future receivable is deemed to be transferred, at the time of the conclusion of the contract of assignment, unless the assignor and the assignee have specified a later time.

References:

A/CN.9/420, paras. 51 and 57
A/CN.9/432, paras. 109-112 and 254-258
A/CN.9/434, paras. 107, 108 and 115-121
A/CN.9/445, paras. 221-226
A/CN.9/456, paras. 76-78 and 98-103

Commentary

96. Article 10 is intended to recognize and, at the same time, limit the right of the assignor and the assignee to agree on the time at which a receivable is transferred; to set a default rule that, in the absence of contrary agreement between the assignor and the assignee, the time at which a receivable is transferred is the time of the conclusion of the contract of assignment; and to clarify the meaning of other relevant provisions, such as articles 7, 9, 19 and 24 to 27. The time of assignment agreed between the assignor and the assignee binds third parties, a matter that may not be sufficiently clear in article 7. However, for such an agreement to be binding on third parties, it has to set a time of transfer that is not earlier than the time of the conclusion of the contract of assignment. This approach is in line with the principle of party autonomy enshrined in article 7, since an agreement setting an earlier time of assignment could affect the order of priority between several claimants (however, neither article 7 nor article 10 precludes the parties from agreeing to ante-date the coming into force of their mutual contractual obligations).

97. In the absence of an agreement between the assignor and the assignee setting the time of transfer of rights in the assigned receivables, the time of such transfer is the time of the conclusion of the contract of assignment, which is a fact that cannot be changed. While this approach is obvious with regard to receivables existing at the time they are assigned, a legal fiction is created with regard to future receivables (i.e. receivables arising from contracts not in existence at the time of the assignment). In practice, the assignee would acquire rights in future receivables only if they were in fact created, but, in legal terms, the time of transfer would go back to the time of the conclusion of the contract of assignment. Giving the assignee a proprietary right in the assigned receivable as of the time of the conclusion of the contract of assignment would result in protecting an assignee with priority under the law of the assignor's location. Without such a proprietary right, even the right of an assignee with priority may be subject to the rights of secured and preferential creditors in the case of insolvency.

Article 11. *Contractual limitations on assignments*

(1) An assignment of a receivable is effective notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee 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 for breach of such an agreement. A person who is not party to such an agreement is not liable on the sole ground that it had knowledge of the agreement.

References:

A/CN.9/420, paras. 61-68
A/CN.9/432, paras. 113-126
A/CN.9/434, paras. 128-137
A/CN.9/445, paras. 49-51 and 227-231
A/CN.9/447, paras. 148-152
A/CN.9/455, paras. 47-51
A/CN.9/456, paras. 104-116
A/CN.9/466, paras. 104-106

Commentary

98. The main objective of article 11, which is inspired by article 6 of the Ottawa Convention, is to establish a balance between the need to protect the debtor, on the one hand, and the need to protect the assignor and the assignee, on the other. The debtor may have good commercial reasons for limiting the ability of the assignor to assign the receivable (e.g. concern of incurring additional expenses). On the other hand, the assignor may need to assign its receivables to obtain financing or a service, and the assignee may have no way of knowing about the existence of a contractual limitation on assignment (as, e.g. in the case of future receivables or bulk assignments).

Substantive and territorial scope

99. Article 11 is intended to apply to contractual limitations, whether contained in the original contract or other agreement between the assignor and the debtor or in the initial or any subsequent assignment contract. It is also intended to apply to any contractual clauses limiting the assignment (e.g. by making it subject to the debtor's consent) and not only to clauses prohibiting assignment. It is not designed to apply, however, to statutory limitations to assignment or to limitations relating to the assignment of rights other than receivables (e.g. confidentiality clauses). As a result, if an assignment is made in violation of a statutory limitation or a confidentiality clause, article 11 does not apply to validate such an assignment or limit any liability existing under law outside the draft Convention. Depending on the approach the Commission decides to take with regard to assignments of financial receivables, the scope of the rule in article 11 may be different and the effectiveness of an assignment in general or only as against the debtor may be left to law applicable outside the draft Convention (see article 5 and paras. 50-54).

100. Article 5 is also intended to apply to assignments of receivables owed by sovereign debtors, unless a State in which that debtor is located makes a reservation under article 38 as to the application of article 11 (see paras. 213 and 214). In such a case too, whether an assignment is effective as against a sovereign debtor would be left to law outside the draft Convention. Furthermore, article 11 is intended to apply to assignments of receivables owed by consumer debtors. It is not intended, however, to override consumer-protection legislation (although, in practice, with the exception of wealthy individuals, who may not need statutory protection, consumers do not have the bargaining power to include such limitations in their contracts; for consumer receivables and consumer protection, see paras. 36, 128, 152, 160 and 196). In any case, consumers would either not even be notified of any assignment or would be

notified and asked to continue paying to the same bank account or post office box. In such a case, a debtor concerned about losing rights of set-off that may arise from contracts unrelated to the original contract could discontinue its relationship with the assignee.

101. In effect, with the limited application of article 11 to consumer situations and with the exclusion of financial service providers (article 5) and the possible exclusion of Governments and public entities (article 38), article 11 would apply mainly to cases where the debtor is a large supplier who may not be in need of statutory protection. In any case, the Commission may wish to consider further limiting the scope of the rule in article 11 to assignments of future receivables or receivables assigned in bulk, in which validating contractual limitations would have a negative impact on the cost of credit. In other assignments (e.g. of single, existing receivables), a contractual limitation would render the assignment ineffective as against the debtor (draft article 12.301 of the European Contract Principles). Such an approach would preserve the free transferability of receivables in important financing transactions, while limiting any undue interference with party autonomy. The Commission may also wish to deal with assignments that are not true assignments but rather take-over bids (i.e. where a competitor obtains an assignment of the debts of an entity in order to obtain access to confidential business information, although if such information is covered by a confidentiality clause and an assignment provides to the assignee access to confidential information, article 11 would not apply to validate such an assignment).

The rule

102. The thrust of the rule in article 11 is that both the contractual limitation on assignment and the assignment are effective. However, unlike the assignment, which is effective as against the debtor, the contractual limitation does not produce any effects as against the assignee. The underlying policy is that it is more beneficial for everyone to facilitate the assignment of receivables and to reduce the transaction cost rather than to ensure that the debtor would not have to pay a person other than the original creditor (assignor). Under article 11 (1), the debtor is bound by the assignment. The question whether there is any liability for breach of contract is left to law applicable outside the draft Convention. If there is any such liability, under article 11 (2), it is not extended to the assignee and cannot be based solely on the assignee's knowledge of the contractual limitation (knowledge may be relevant in the case of tortious liability of the assignee, e.g. for malicious interference with advantageous contractual relations). Penalizing the assignee for having mere knowledge of the anti-assignment clause would inadvertently result in encouraging the assignee either to avoid a due-diligence test or to proceed with such a test and refuse to accept the receivables or accept them at a much lower price. Other rights that the debtor may have under law outside the draft Convention such as, for example, the right to terminate the original contract for breach of contract, are not affected either, unless a financial receivable is involved (see, article 5, variant A, paragraph (2); for a secretariat suggestion to limit the rights of the debtor to a claim for compensatory damages, see para. 104).

Justification

103. Contractual limitations have a negative impact on the value of receivables, whether they relate to all receivables assigned in bulk or only to some. If contractual limitations were enforceable as against assignees, assignees would have to examine the documentation of each receivable. As a result, a small number of receivables that are subject to contractual limitations would raise the cost on a much larger number of receivables that are not subject to any such restriction. In addition, unless they are aimed at preserving legitimate interests, contractual limitations may constitute an undue interference with market economy principles. To the extent that the payment obligation has the same effect on the debtor, irrespective of the identity of the creditor, a contractual restriction would run counter to the principle against restraints of alienation of property. Furthermore, an economy in which receivables are freely transferable yields substantial benefits to debtors. The cost savings achieved for creditors through the free transferability of their receivables can be passed along to debtors in the form of lower costs for goods and services or lower cost for credit.

104. In any case, the draft Convention provides a high level of protection to the debtor (articles 17-22). In addition, under law applicable outside the draft Convention, the debtor may even declare the original contract avoided (with the exception of debtors of financial receivables; article 5, variant A, para. (2)). Such avoidance of the contract, however, which could deprive the assignee of the contractual right to demand payment from the debtor, should be available only in exceptional circumstances (the assignor may have an unjust enrichment claim or other claims arising by operation of law against the debtor but any assignment of such rights would not be covered by the draft Convention). Otherwise, the risk of the contract being avoided might in itself have a negative impact on the cost of credit. In order to avoid this result, the Commission may wish to consider clarifying in article 11 that any relief available to the debtor against the assignor for breach of an anti-assignment clause would be limited to a claim for compensatory damages (or that the debtor may not declare the original contract avoided on the sole ground that the assignor violated an anti-assignment clause; see article 5, variant A, paragraph (2)). Articles 11, 20 (3) and 22 could be construed as precluding such a radical remedy anyway, at least after notification of the assignment. Allowing the debtor to declare the contract avoided on the sole ground of the violation of an anti-assignment clause would run counter to the principle that the assignment is effective even if it is made in violation of an anti-assignment clause and to the principle that, in such a case, the debtor may not raise against the assignee any claim it might have against the assignor for breach of contract. In addition, if the minimum, that is, a modification of the original contract, is not allowed after notification of the debtor without the consent of the assignee, the maximum, that is the cancellation of the contract, could not be allowed either. Such a limitation of the debtor's cancellation rights may be combined with the approach taken in article 5, variant B, paragraph (2). If the assignment is ineffective as against the debtor, the debtor would not need to cancel the original contract simply because of a violation of a contractual limitation on assignment (see para. 102).

Article 12. *Transfer of security rights*

(1) A personal or property right securing payment of the assigned receivable is transferred to the assignee without a new act of transfer, unless, under the law governing the right, it is transferable only with a new act of transfer. If such a right, under the law governing it, is transferable only with a new act of transfer, the assignor is obliged to transfer this right and any proceeds to the assignee.

(2) A right securing payment of the assigned receivable is transferred under paragraph (1) of this article notwithstanding an agreement between the assignor and the debtor or other person granting the right, limiting in any way the assignor's right to assign the receivable or the right securing payment of the assigned receivable.

(3) Nothing in this article affects any obligation or liability of the assignor for breach of an agreement under paragraph (2) of this article. A person who is not a party to such an agreement is not liable on the sole ground that it had knowledge of the agreement.

(4) 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.

(5) 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 receivable.

References:

A/CN.9/420, paras. 69-74
A/CN.9/432, paras. 127-130
A/CN.9/434, paras. 138-147
A/CN.9/445, paras. 232-235
A/CN.9/456, paras. 117-126

Commentary

Accessory and independent rights

105. Paragraph (1) reflects the generally accepted principle that accessory security rights (e.g. a suretyship, pledge or mortgage) are transferred automatically, while independent security rights (e.g. an independent guarantee or a standby letter of credit or a real security right of an abstract nature) are transferable only with a new act of transfer (the words "right securing payment" are used in order to ensure that rights that may not be security rights, for example, rights arising from independent guarantees and standby letters of credit, would be covered). Under article 7, the assignor and the assignee may agree that an accessory right is not transferred to the assignee and is thus extinguished. Such an agreement may reflect the lack of willingness on the part of the assignee to accept the responsibility and the cost involved in the maintenance and safekeeping of collateral (e.g. taxation and insurance costs in the case of real estate or storage and insurance costs in the case of equipment). The question of the accessory or independent character of the right and the substantive or procedural requirements to be met for the creation of such a right are left to the law governing that right. In view of the wide range of rights covered by article 12 and the divergences existing among the various legal systems in this regard, article 12 does not attempt to specify the law applicable to such rights. Paragraph (1) also creates an obligation for the assignor to transfer to the assignee any independent right securing payment of the assigned receivables as well as the proceeds of such a right. As a result, if an independent right and its proceeds are assignable, the assignee will be able to obtain them. If such rights are not assignable or not assigned for any reason, the assignee will have a personal claim against the assignor. As to the formulation of paragraph (1), the Commission may wish to consider deleting the second part of the first sentence (i.e. the words "unless ... transfer") as superfluous (the first part of the second sentence may be sufficient).

Contractual limitations

106. Paragraph (2) is intended to ensure that any limitation agreed upon between the assignor and the debtor or other person granting a security right does not invalidate the assignment. Under paragraph (3), any liability that the assignor may have for breach of contract, under law applicable outside the draft Convention, is not affected but is not extended to the assignee (this approach is consistent with the approach taken in article 11). The underlying policy is that, with regard to limitations on assignment, security rights should be treated in the same way as receivables, since often the value relied upon by the assignee lies in the security right and not in the receivable itself. However, a limitation included in a contract with a sovereign third-party guarantor located in a State that has made a declaration under article 38 would render the assignment ineffective but only as against the sovereign third-party guarantor. Similarly, a limitation in a contract with a third-party guarantor of a financial receivable may invalidate the assignment in general or only as against the third-party guarantor, depending on whether the Commission adopts variant A or variant B of article 5.

Possessory rights

107. Whether or not the transfer of a security right is prohibited by agreement, if it involves the transfer of possession of the collateral and such transfer causes damage to the debtor or the person granting the right, any liability that may exist under law applicable outside the draft Convention is not affected. Paragraph (4) envisages, for example, a transfer of pledged shares that might empower a foreign assignee to exercise the rights of a shareholder to the detriment of the debtor or any other person who might have pledged the shares.

Form requirements

108. Under paragraph (5), any requirements of the law applicable outside the draft Convention relating to the form of the transfer of security rights are not affected. As a result, a notarized document and registration may be necessary for the effective transfer of a mortgage, while delivery of possession or registration may be required for the transfer of a pledge. In addition, the draft Convention is not intended to affect any requirements as to the form of an

assignment of receivables secured by a certain asset (e.g. registration of an assignment secured by real estate or by aircraft). However, if the Commission includes a rule on the form of assignment, subjecting the form of the assignment to the law of the assignor's location (see paras. 80-82), that rule would need to be aligned with paragraph (5) (e.g, by providing that the law of the assignor's location would govern form, unless the receivables are backed by a security right, in which case the law governing that right would govern form).

CHAPTER IV. RIGHTS, OBLIGATIONS AND DEFENCES

Section I. Assignor and assignee

Commentary

Purpose of section I

109. Unlike the other provisions of the draft Convention that deal with the proprietary aspects of assignment, the provisions contained in this section deal with contractual issues. The usefulness of these provisions lies in the fact that they recognize party autonomy, a principle enshrined in a general way in article 7, and provide default rules applicable in the absence of an agreement between the assignor and the assignee. Such default provisions offer important benefits. They reduce transaction costs by allocating risks and by eliminating the need for parties to replicate standard terms and conditions in their contract. They also reduce dispute resolution costs by providing a clear-cut rule for both the courts and the parties in the event the parties have not addressed a particular issue. Furthermore, they perform a useful educative function by offering a checklist of matters for parties to address at the time of the initial contract negotiations. Most significantly, they enhance uniformity and certainty by reducing the need for courts to look to national solutions offered by the proper law of the contract. However, the role of the proper law of the contract is not wholly eliminated in section I of chapter IV. The effect of mistake, fraud or illegality on the validity of the contract is left to the proper law of the contract, as are remedies available for breach of contract (in so far as they are not characterized as procedural and are, therefore, subject to the lex fori).

Article 13. *Rights and obligations of the assignor and the assignee*

(1) The rights and obligations of the assignor and the assignee as between them 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.

References:

A/CN.9/432, paras. 131-144
A/CN.9/434, paras. 148-151
A/CN.9/447, paras. 17-24
A/CN.9/456, paras. 127 and 128

Commentary

110. The primary purpose of article 13 is to restate in the context of the relationship between the assignor and the assignee the principle of party autonomy, a principle already reflected in general terms in article 7. The assignor and the assignee are free to structure their mutual rights and obligations so as to meet their particular needs. They are also free to incorporate into their agreement any rules or conditions by referring to them in a general manner, rather than reproducing them in their agreement. The conditions, under which the parties may exercise their freedom, and the relevant legal consequences are left to the law governing their agreement. In line with article 9 of the United Nations Sales Convention, article 13 also states in paragraphs (2) and (3) a principle that may not be recognized in all legal systems, namely, that, in the interpretation of assignment contracts, trade usages and practices must be taken into account. Paragraph (2) draws a clear distinction between trade usages and practices established between the assignor and the assignee. Such usages and practices may produce rights and obligations for the assignor and the assignee. However, they cannot bind third parties, such as the debtor or creditors of the assignor. They cannot bind subsequent assignors or assignees either. All those parties would not necessarily be aware of usages agreed upon by, and practices established between, the initial assignor and the initial assignee.

111. In view of the recognition of party autonomy in paragraph (1), parties will always have the right to agree otherwise as to the binding nature of practices established between themselves. The words "unless otherwise agreed" contained in paragraph (2) may therefore not be necessary. These words, which do not appear in article 9 (1) of the United Nations Sales Convention, had initially been included in paragraph (2), since, as opposed to the hierarchy of legal rules established in the United Nations Sales Convention, the draft Convention prevails over the parties' agreement. After the limitation of paragraph (1) to the mutual rights and obligations of the assignor and the assignee, the rule about the prevalence of the draft Convention has been deleted and the reason for deviating from the wording of article 9 (1) of the United Nations Sales Convention has been eliminated.

112. Paragraph (3) defines the scope of the matters covered by an international usage. Under paragraph (3), international usages bind only the parties to international assignments. Such a limitation was not thought to be necessary in article 9 of the United Nations Sales Conven-

tion since this Convention applies only to international transactions. It is, however, necessary in article 13 in view of the fact that the draft Convention may apply to domestic assignments of international receivables. In addition, under paragraph (3), as under article 9 (2) of the United Nations Sales Convention, usages are applicable only to the relevant practice. This means that an international factoring usage cannot apply to an assignment in a securitization transaction. However, unlike article 9 (2) of the United Nations Sales Convention, paragraph (3) does not refer to the subjective, actual or constructive knowledge of the parties but only to the objective requirements that the usages must be widely known and regularly observed. The Working Group felt 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. In view of the fact that article 13 has been revised to make clear that it refers to the rights and obligations of the assignor and the assignee as between themselves and that, under article 7, agreements between parties do not affect third parties, the Commission may wish to reconsider this matter.

Article 14. *Representations of the assignor*

(1) Unless otherwise agreed between the assignor and the assignee, the assignor represents at the time of the conclusion 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.

References:

A/CN.9/420, paras. 80-88
A/CN.9/432, paras. 145-158
A/CN.9/434, paras. 152-161
A/CN.9/447, paras. 25-40
A/CN.9/456, paras. 129 and 130

Commentary

Party autonomy/default rules

113. Representations undertaken by the assignor are intended to reduce the risk of whether the assignee will be able to collect the receivables from the debtor, if necessary. Because of their purpose, representations constitute a significant factor in the assignee's determination of the amount of credit to be made available to the assignor and the cost of credit. In view of their importance, representations are highly negotiated and explicitly settled between the assignor and the assignee. Recognizing this reality, article 14 embodies the principle of party autonomy with regard to representations of the assignor. Such representations may stem from the financing contract, the contract of assignment (if it is a separate contract) or any other contract between the assignor and the assignee. In accordance with article 13 (2) and (3), they may also stem from trade usages and practices. Article 14 allows parties to modify the representations, whether explicitly or implicitly, even those which relate to the very existence of the assigned receivable.

114. In addition to recognizing the principle of party autonomy, article 14 is intended to set forth a default rule allocating risks between the assignor and the assignee in the absence of an agreement of the parties as to this matter. In the allocation of risks, the overall aim of article 14 is to counterbalance the need for fairness and the need to facilitate increased access to lower-cost credit. Article 14 is consistent with normal practice in which the assignor guarantees the existence of the assigned receivable but not the solvency of the debtor. If the parties have not agreed on representations, in the absence of a rule along the lines of article 14, the risk of non-payment would be higher. This situation could defeat a transaction (if the risk is too high) or, at least, reduce the amount of credit offered and raise the cost of credit. Furthermore, to the extent that the assignor has to bear a certain risk, the assignor's goods or services would be more expensive or even inaccessible to the debtor.

Representations as to the "existence" or assignability of a receivable

115. Under paragraph (1), the assignor represents that it has the right to assign the receivable, that it has not assigned it already and that the debtor does not and will not have any defences. In view of the need for the assignee to be able to estimate the risk involved in a transaction before extending credit, paragraph (1) provides that the representations have to be made, and take effect, at the time of the conclusion of the contract of assignment. Such representations are considered as being given not only to the immediate assignee but also to any subsequent assignee. As a result, any subsequent assignee may turn against the assignor for breach of representations. If representations were considered as being undertaken only as against the immediate assignee, any subsequent assignee would have recourse only against its immediate assignor, a process that would increase the risk and thus the cost of transactions involving subsequent assignments. Subparagraphs *(a)* to *(c)* introduce representations that could be broadly described as representations relating to "the existence" of the receivable (or its assignability). If the assignor does not have the power to assign, has already assigned or has deprived the receivable of any value by improperly performing the contract with the debtor, the receivable does not "exist". The Commission may wish to consider whether other existence-related representations, such as the factual basis of the claim, its formal and substantive validity and enforceability are sufficiently covered (see draft article 12.204 of the European Contract Principles).

116. The assignor is in violation of the representation as to its right to assign, introduced in subparagraph *(a)*, if it does not have the capacity or the authority to act, or if there

is any statutory limitation on assignment. This approach is justified by the fact that the assignor is in a better position to know whether it has the right to assign. However, the assignor is not liable for breach of representations if the original contract contains a limitation on assignment. The Working Group decided that no explicit reference to that rule was necessary in subparagraph *(a)*, since it is implicit in article 11, under which the assignment is effective even if it is in breach of an agreement limiting assignment. The representation, contained in subparagraph *(b)*, that the assignor has not already assigned the receivable is aimed at holding the assignor accountable to the assignee if, as a result of a previous assignment by the assignor, the assignee does not have priority. This result may occur if the assignee has no objective way of determining whether a previous assignment has occurred. Subparagraph *(b)*, however, does not require the assignor to represent that it will not assign the receivables to another assignee after the first assignment. Such a representation would run counter to modern financing practice in which the right of the assignor to offer to different lenders parts of the same receivables as security for obtaining credit is absolutely essential. The Commission may wish to consider whether subparagraph *(b)* should cover also assignments or other transfers by law (see draft article 12.204 *(c)* of the European Contract Principles).

117. Subparagraph *(c)* places on the assignor the risk of hidden defences or rights of set-off of the debtor that may defeat in whole or in part the assignee's claim. This provision is premised on the fact that, by performing its contract with the debtor properly, the assignor will be able to preclude such defences from arising. In particular in the context of the sale of goods in which service and maintenance elements are included, such an approach would result in a greater degree of accountability of the assignor for performing properly its contract with the debtor. The provision is also based on the assumption that, in any case, the assignor will be in a better position to know whether the contract will be properly performed, even if the assignor is just the seller of goods manufactured by a third person (there is no need for the assignor to have actual knowledge of any defences). Furthermore, subparagraph *(c)* is premised on the fact that placing on the assignor the risk of hidden defences normally has a beneficial impact on the cost of credit. Subparagraph *(c)* has a wide scope, encompassing defences and rights of set-off whether they have a contractual or non-contractual source and whether they relate to existing or to future receivables. It also covers rights of set-off, whether they arise from the original or any related contract or from contracts unrelated to the original contract (with the exception of rights of set-off from unrelated contracts that become available after notification, which under article 20 (2) the debtor cannot raise against the assignee). With regard to representations relating to the absence of defences against future receivables assigned in bulk by way of security, the Working Group thought that the representation contained in subparagraph *(c)* properly reflected current practice. According to such practice, in bulk assignments of defence-free and defence-ridden receivables assignors normally receive credit only in the amount of those receivables which are not likely to be subject to defences, while they have to repay a higher amount. In addition, in the case of non-payment by the debtor, the assignor has to take back the receivables for which the assignee is not able to obtain payment from the debtor and replace them with other receivables or to pay back the price of the unpaid receivables ("recourse financing").

Representations as to the solvency of the debtor

118. Paragraph (2) reflects the generally accepted principle that the assignor does not guarantee the solvency of the debtor. As a result, the risk of debtor default is on the assignee, a fact that the assignee takes into account in determining whether to extend credit and on what conditions. Recognizing the right of the parties to financing transactions to agree on a different risk-allocation, paragraph (2) allows the assignor and the assignee to agree otherwise. Paragraph (2) also provides that such an agreement may be implicit or explicit. The question of what constitutes an implicit agreement is left to the contract interpretation rules of the law governing the contract.

Additional representations

119. The Commission may wish to consider adding to the representations listed in paragraph (1) that the assignor will not modify the original contract without the actual or constructive consent of the assignee (article 22) and that the assignor will transfer to the assignee any non-accessory security or other supporting rights (article 12; see also article 12.204 *(d)* and *(e)* of the European Contract Principles).

Breach of representations

120. The Working Group decided to leave the legal consequences of a breach of representations to other law. Reasons cited by the Working Group in support of this approach include that matters relating to the underlying financing contract were beyond the scope of the draft Convention and, in any case, it would be very difficult to reach agreement on issues such as liability for breach of representations. The Commission may wish to consider addressing, at least, any consequences a breach of representations may have on the assignment (i.e. whether the receivables are automatically re-transferred to the assignor or whether a new act of transfer is necessary). This issue is of particular importance if the assignor becomes insolvent after a breach of representations.

Article 15. *Right to notify the debtor*

(1) Unless otherwise agreed between the assignor and the assignee, the assignor or the assignee or both may send the debtor a notification of the assignment and a payment instruction, but after notification is sent only the assignee may send a payment instruction.

(2) A notification of the assignment or payment instruction sent in breach of any agreement referred to in paragraph (1) of this article is not ineffective for the purposes of article 19 by reason of such breach. 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.

References:

A/CN.9/420, paras. 89-94 and 119-122
A/CN.9/432, paras. 159-164 and 175
A/CN.9/434, paras. 162-165
A/CN.9/447, paras. 41-47
A/CN.9/456, paras. 131-144 and 193
A/CN.9/466, paras. 116 and 117

Commentary

Independent right of the assignee to notify the debtor and request payment

121. The main objective of article 15 is to recognize the right of the assignee to notify the debtor and to request payment, even without the cooperation or the authorization of the assignor. It is not intended to define notification (article 6) or to address the conditions for a notification to be effective as against the debtor (article 18) or the legal consequences of notification (articles 19, 20 and 22). Granting the assignee an autonomous right to notify the debtor is considered important, in particular since the assignor might be unwilling or, in the case of insolvency, unable to cooperate with the assignee. Furthermore, at least in those legal systems in which priority is determined on the basis of the time of notification of the debtor, the assignor, acting in collusion with one claimant against the interests of another claimant, could determine the order of priority, unless each claimant had the right to notify the debtor independently of the assignor. The Working Group recognized that, in some practices, it was normal for the assignor to send a bill to the debtor requesting payment and notifying the debtor about the assignment (e.g. in factoring). At the same time, however, the Working Group was mindful of the fact that, in other practices, it was important for the assignee to be able to notify and to request payment independently of the assignor, whether in the event of default or not. The protection of the debtor against the risk of being notified and being asked to pay a potentially unknown person was thought to be a different matter, which could be addressed by allowing the debtor in the case of notification by the assignee to request adequate proof (by definition, a notification has to identify the assignee; see para. 60; see also draft article 12.303 of the European Contract Principles, under which, in such a case the assignment has to be in writing and the debtor has to have a chance to inspect it).

Notification as a right, not an obligation

122. With a view to accommodating non-notification practices, notification is formulated in paragraph (1) as a right and not as an obligation. In such practices, normally the debtor is not notified of the assignment and the assignor receives payment on behalf of the assignee. Article 15 is also intended to recognize practices in which the debtor keeps paying as before the assignment, while the assignor and the assignee agree on the control of the bank account or post office box to which payment is made. In those practices, in order to avoid any inconvenience to the debtor that might result in an interruption to the normal flow of payments, the debtor is either not notified at all or is notified and instructed to continue paying the assignor (such a notification is normally intended to preclude the debtor from acquiring rights of set-off after notification from contracts unrelated to the original contract). In those practices, the debtor is notified and given different payment instructions (i.e. to pay the assignee or another person or to a different account or address) only in exceptional situations (e.g. in the case of default).

Notification and payment instruction

123. In line with the approach followed in article 6 *(e)* (which defines notification without any reference to a payment instruction), paragraph (1) draws a clear distinction between a notification and a payment instruction. This approach is intended to recognize the difference, both in purpose and in time, between a notification and a payment instruction and to validate practices in which notification is given without any payment instructions. Under this approach, a mere notification of an assignment is valid for the purpose of cutting off the debtor's rights of set-off arising from contracts unrelated to the original contract, as well as for the purpose of changing the way in which the assignor and the debtor may amend the original contract. However, in order to avoid complicating the debtor's discharge, the Working Group decided not to base the debtor's discharge on the receipt of a payment instruction. Under paragraph (1), a payment instruction may be sent either by the assignor or the assignee with the notification or, subsequent to a notification, by the assignee. Paragraph (1), unlike article 19, refers to the time notification is "sent" (and not "received"), since neither the assignor nor the assignee has a way to assess the time of receipt. That matter may be important for the discharge of the debtor, dealt with in article 19, but not for the determination of who has the right to give a payment instruction as between the assignor and the assignee.

Agreements as to notification

124. While paragraph (1) grants the assignee an autonomous right to notify the debtor and to request payment, paragraph (2) recognizes the right of the assignor and the assignee to negotiate and agree on the matter of notification of the debtor so as to meet their particular needs. For example, the assignor and the assignee may agree that no notification would be given to the debtor as long as the flow of payments is not interrupted (as, e.g. in undisclosed invoice discounting). In order to ensure that there is no need for a specific agreement, the opening words of paragraph (1) are formulated in a negative way ("unless otherwise agreed"). The rule introduced in paragraph (2) is that, if notification is given in violation of such an agreement and the debtor pays, the debtor is discharged. The underlying rationale is that the debtor should be able to discharge its obligation as directed in the notification and should not concern itself with the private arrangements existing between the assignor and the assignee. Whether the person violating such an agreement is liable for breach of contract under law applicable outside the draft Convention is a separate matter and should not affect the discharge of the debtor, who is not a party to that agreement. A notification given in violation of an agreement between the assignor

and the assignee, however, does not cut off any rights of set-off of the debtor from contracts unrelated to the original contract (article 20), trigger a change in the way the assignor and the debtor may amend the original contract (article 22), or create a basis for the determination of priority under the law applicable to priority issues (articles 24-26). The Working Group thought that such results would give an undue advantage to the assignee who wrongfully notified the debtor. The negative formulation in paragraph (2) "is not ineffective" is intended to ensure that the mere violation of an agreement between the assignor and the assignee, on the one hand, does not invalidate the notification for the purpose of debtor-discharge, but, on the other hand, does not interfere with contract law as to the conditions required for such an agreement to be effective.

Article 16. *Right to payment*

(1) As between the assignor and the assignee, unless otherwise agreed, and whether or not a notification of the assignment has been sent:

(a) If payment in respect of the assigned receivable is made to the assignee, the assignee is entitled to retain the proceeds and goods returned in respect of the assigned receivable;

(b) If payment in respect of the assigned receivable is made to the assignor, the assignee is entitled to payment of the proceeds and is also entitled to goods returned to the assignor in respect of the assigned receivable; and

(c) If payment in respect of the assigned receivable is made to another person over whom the assignee has priority, the assignee is entitled to payment of the proceeds and is also entitled to goods returned to such person in respect of the assigned receivable.

(2) The assignee may not retain more than the value of its right in the receivable.

References:

A/CN.9/447, paras. 48-68
A/CN.9/456, paras. 145-159
A/CN.9/466, paras. 118-123

Commentary

Objective and scope

125. Article 16 is intended to state explicitly what is already implicit in articles 2 and 9, namely, that, as between the assignor and the assignee, the assignee has a proprietary right in the assigned receivable and any proceeds (as against third parties, this matter is left to the law governing priority under article 24 *(b)*). As the scope of article 16 is limited to the relationship between the assignor and the assignee, it is subject to the general principle of party autonomy embodied in article 7 and is intended to operate as a default rule applicable in the absence of an agreement between the assignor and the assignee. It is not intended to affect the debtor's legal position or issues of priority.

Rights in proceeds and returned goods

126. As between the assignor and the assignee, the assignee's right extends to proceeds (which, under article 6 *(k)*, includes both proceeds of receivables and proceeds of proceeds), as well as to returned goods. In this context, the Working Group considered that there was no reason to limit the ability of the assignor and the assignee to agree that the assignee could claim any returned goods and that, even in the absence of an agreement, a default rule allowing the assignee to claim any returned goods could reduce the risks of non-collection from the debtor and thus have a positive impact on the cost of credit. Paragraph (1) covers situations in which payment has been made to the assignee, the assignor or another person. In the latter case, the assignee's right is, under paragraph (1) *(c)*, subject to priority. Paragraph (2) reflects normal practice in assignments by way of security, under which the assignee may have the right to collect the full amount of the receivable owed, plus interest owed on the ground of contract or law, but has to account for and return to the assignor or its creditors any balance remaining after payment of the assignee's claim. Paragraph (2) does not repeat the reference to a contrary agreement of the parties, which is included in the chapeau of paragraph (1), since the assignee's right in the assigned receivable flows from the assignment contract and is, under article 13, subject to party autonomy anyway. As to the interplay between articles 16 and 38, it should be noted that a sovereign debtor, located in a State that has made a reservation under article 38, could discharge its debt by paying the assignor, while the assignee would have a right to claim the proceeds of payment from the assignor.

Notification of the debtor

127. The assignee's right in proceeds is independent of any notification of the assignment. The reason for this approach is the need to ensure that, if payment is made to the assignee before notification, the assignee may retain the proceeds of payment, and if payment is made to the assignor after notification (which does not discharge the debtor's debt), the assignee would have a right in such payment. Such a right is of particular importance if the assignor or the debtor becomes insolvent. If payment is made to the assignor after notification, in principle the assignee could claim payment from the assignor, under article 16 (1) *(b)*, or from the debtor, under article 19 (2). This result is appropriate in that the debtor, who pays the assignor after notification, takes the risk of having to pay twice. In practice, however, the assignee would not claim a second payment from the debtor, unless the assignor has become insolvent. In such a case, any claim that the debtor might have against the estate of the insolvent assignor (e.g. on the basis of the principles of unjust enrichment) would normally be meaningless, since it is unlikely that claimants with personal claims would be able to obtain payment.

Section II. Debtor

Article 17. *Principle of debtor protection*

(1) Except as otherwise provided in this Convention, an assignment does not, without the consent of the debtor, affect the rights and obligations of the debtor, including the payment terms contained in the original contract.

(2) A payment instruction may change the person, address or account to which the debtor is required to make payment, but may not:

(a) Change the currency of payment specified in the original contract, or

(b) Change the State specified in the original contract, in which payment is to be made, to a State other than that in which the debtor is located.

References:

A/CN.9/420, para. 101
A/CN.9/432, paras. 33-38, 89, 90, 206 and 244
A/CN.9/434, paras. 86-95
A/CN.9/445, paras. 195-198
A/CN.9/456, paras. 21, 81 and 168-176

Commentary

Principle of debtor protection

128. The principle of debtor protection is one of the main general principles of the draft Convention. It is referred to in a general manner in the preamble and in article 17. Furthermore, it is reflected in a number of provisions of the draft Convention (e.g. articles 1 (3), 5, 7, 19-23, 28 and 38). The thrust of the rule set forth in paragraph (1) is that there are no implied effects of the draft Convention on the legal position of the debtor (any doubt as to whether an assignment changes the debtor's legal position should be resolved in favour of the debtor). The draft Convention is, in particular, not designed to change, without the consent of the debtor, the payment terms stipulated in the original contract (e.g. the amount owed, whether for principal or interest; the date of payment; and any conditions precedent to the debtor's obligation to pay), the defences or rights of set-off that the debtor may raise under the original contract, or to increase expenses in connection with payment. A principle flowing from article 17 is that the draft Convention is not intended to have an adverse effect on the rights of consumer debtors and, in particular, to override consumer-protection legislation (articles 21 (1) and 23; for consumer receivables and consumer protection, see paras. 36, 100, 152, 160 and 196).

Country and currency risk

129. Whatever change is effected in the debtor's legal position as a result of an assignment under the draft Convention, under paragraph (2), a payment instruction, whether given with the notification or subsequently, may not change the currency of payment. It may not change the country of payment either, unless the change is beneficial to the debtor and results in payment being allowed in the country in which the debtor is located. Such a change of the country of payment is often allowed in factoring contracts with a view to facilitating payment by debtors. The Commission may wish to make even that change subject to the debtor's consent so as to cover those exceptional cases in which the debtor may have an interest in paying in the country identified in the original contract and not in its own country.

Article 18. *Notification of the debtor*

(1) A notification of the assignment and a payment instruction are effective when received by the debtor, if they are in a language that is reasonably expected to inform the debtor about their contents. It shall be sufficient if a notification of the assignment or a payment instruction is in the language of the original contract.

(2) A notification of the assignment or a payment instruction may relate to receivables arising after notification.

(3) Notification of a subsequent assignment constitutes notification of any prior assignment.

References:

A/CN.9/420, paras. 124 and 125
A/CN.9/432, paras. 176,177 and 187
A/CN.9/434, paras. 172-175
A/CN.9/447, paras. 45-47, 158 and 159
A/CN.9/455, paras. 59-66
A/CN.9/456, paras. 177-180

Commentary

Time of effectiveness of notification: the receipt rule

130. The primary purpose of article 18 is to restate the "receipt rule" with regard to the time of effectiveness of a notification, that is, that a notification and a payment instruction become effective when received by the debtor. A notification, whether accompanied by a payment instruction or not, has significant consequences for the legal position of the debtor (it triggers a change in the way in which the debtor may discharge its debt, it cuts off rights of set-off arising from contracts unrelated to the original contract and it changes the way in which the debtor may amend the original contract in agreement with the assignor). Such consequences may occur only when a notification or a payment instruction is in a language that is "reasonably expected to inform the debtor about its contents". For example, when the notification is in electronic form and is not readily readable, the debtor should be able to decode it easily. In order to avoid creating uncertainty, paragraph (1) introduces a "safe harbour" rule, according to which the language of the original contract meets the required standard.

Notification with respect to receivables not existing at the time of notification

131. Unlike article 8 (1) *(c)* of the Ottawa Convention, which provides that notification may be given only with respect to receivables existing at the time of notification (and which reflects current factoring practice), paragraph (2) allows a notification to be given with respect to receivables not existing at the time of notification. Such a notification may not have an impact on the debtor's discharge until the original contract is concluded and the payment obligation becomes due. However, it simplifies and reduces the cost of notification in that it ensures that the assignee does not need to give a notification each time a receivable

arises. It also ensures that, once a receivable arises, the debtor cannot accumulate rights of set-off from unrelated contracts with the assignor or modify the original contract without the consent of the assignee. More importantly, such a notification allows the assignee to obtain priority, once the receivable arises, as of the time notification is received by the debtor, if, under the law of the assignor's location, priority is determined on the basis of the time of notification (in order to achieve this result, draft article 24 provides that matters settled in the draft Convention, including notification-related matters, are excluded from the law of the assignor's location; see para. 163). The time when a receivable arises is left to law applicable outside the draft Convention.

Notification in subsequent assignments

132. Paragraph (3), which is inspired by article 11 (2) of the Ottawa Convention, is one of the most important provisions of the draft Convention, in particular for international factoring transactions. In such transactions, the assignor normally assigns the receivables to an assignee in its own country (export factor) and the export factor subsequently assigns the receivables to an assignee in the debtor's country (import factor). Under such an arrangement, collection from the debtor is facilitated to the extent that the import factor is able to take all the necessary measures for the second assignment to be effective as against the debtor. The efficient operation of such transactions is based on the assumption that the first assignment is also effective as against the debtor. In view of the fact that the debtor is normally notified only of the second assignment, it is essential to ensure that notification of the second assignment covers the first assignment as well. Otherwise, the first assignment might be rendered ineffective as against the debtor, a situation that might affect the effectiveness of the second assignment as well. In order to address situations in which more than one subsequent assignment is made, paragraph (3) provides that a notification covers any prior, and not only the immediately preceding, assignment (with regard to the issue of the discharge of the debtor in the case of several notifications relating to subsequent assignments, see para. 138). The Commission may wish to consider whether a notification should indicate that it relates to a subsequent assignment, even if it does not list all the subsequent assignments. Such an approach would allow the debtor to determine, in the case of multiple notifications, whether it should pay in accordance with the first notification received (article 19 (2)) or in accordance with the notification of the last of such subsequent assignments (article 19 (4)).

Article 19. *Debtor's discharge by payment*

(1) Until the debtor receives notification of the assignment, the debtor is entitled to be discharged by paying in accordance with the original contract. After the debtor receives notification of the assignment, subject to paragraphs (2) to (6) of this article, the debtor is discharged only by paying the assignee or, if otherwise instructed in the notification of the assignment or subsequently by the assignee in a writing received by the debtor, in accordance with such instructions.

(2) If the debtor receives notification of more than one assignment of the same receivable made by the same assignor, the debtor is discharged by paying in accordance with the first notification received.

(3) If the debtor receives more than one payment instruction relating to a single assignment of the same receivable by the same assignor, the debtor is discharged by paying in accordance with the last payment instruction received from the assignee before payment.

(4) If the debtor receives notification of one or more subsequent assignments, the debtor is discharged by paying in accordance with the notification of the last of such subsequent assignments.

(5) If 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.

(6) 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.

References:

A/CN.9/420, paras. 98-117, 127-131, 169-173 and 179
A/CN.9/432, paras. 165-174 and 178-204
A/CN.9/434, paras. 176-191
A/CN.9/447, paras. 69-93 and 153-157
A/CN.9/455, paras. 52-58
A/CN.9/456, paras. 181-193
A/CN.9/466, paras. 124-132

Commentary

133. Article 19 has a twin goal, to provide a clear mechanism for the discharge of the debtor's obligation by payment and to ensure payment of the debt. It is not intended to deal with the discharge of the debtor in general or with the payment obligation as such, since that obligation is subject to the original contract and to the law governing that contract. It is not intended to address issues of priority either. The basic rule is that, until the debtor receives notification of an assignment, it may be discharged by paying in accordance with the original contract, while, after notification, discharge is obtained only by payment in accordance with the instructions given by the assignor or by the assignee with the notification, or subsequently by the assignee. Article 19 deals also with a number of particular situations in which several notifications are involved, the debtor is notified by the assignee and is in doubt as to whether the assignee is the rightful claimant, and with discharge effected by payment under law applicable outside the draft Convention.

Debtor's discharge by payment before and after notification

134. Under paragraph (1), until the time of receipt of a notification, the debtor is entitled to discharge by paying in accordance with the original contract (i.e. by paying the assignor or another person or to an account or address indicated in the original contract). In view of the fact that the assignment is effective as of the time of the conclusion of the contract of assignment, the debtor, having knowledge of the assignment, may choose to discharge its debt by paying the assignee. However, in such a case the debtor takes the risk of having to pay twice, if it is later proved that no assignment took place. The Working Group decided not to refer explicitly to the possibility of the debtor being able to pay either the assignor or the assignee in order to avoid undermining practices, such as securitization, in which the debtor is normally expected to continue paying the assignor. The reference to payment "in accordance with the original contract", rather than to payment to the assignor, is intended to preserve the right of the assignor and the debtor to agree to any type of payment suitable to meet their needs (e.g. payment to a bank account without identification of the account owner, or payment to a third person).

135. After notification, the debtor does not have a choice as to how to discharge its debt. The debtor may only discharge its obligation by paying the assignee or as instructed by the assignee. The reference to payment instructions is intended to address the needs of various practices. The assignee may, for example, notify the debtor, so as to freeze the debtor's rights of set-off, without requesting payment or requesting the debtor to continue paying the assignor (this is the case, e.g. with undisclosed invoice discounting or securitization). To avoid leaving any uncertainty, paragraph (1) repeats what is already stated in article 15 (1), namely, that such instructions may be given by the assignor or the assignee with the notification or only by the assignee subsequent to a notification.

Knowledge/good faith

136. Knowledge of an assignment is not to be treated as a notification and to trigger a change in the way in which the debtor could discharge its obligation. While making business practice conform to good faith standards is an important goal, this should not be at the expense of certainty. Certainty would be reduced if knowledge of the assignment were to trigger a change in the way in which the debtor could discharge its obligation. Knowledge should not be treated as a notification, since, in certain cases in which the assignee does not have the business structure necessary to receive payments (e.g. in securitization), it is normal business practice for the debtor to continue paying the assignor even though the debtor knows of the assignment. With regard to whether the nullity (e.g. for fraud or duress or lack of capacity to act) or whether the knowledge of the nullity of an assignment should be taken into account in the debtor's discharge, the Working Group decided that the issue of payment to a person, the assignment to whom was null and void, arose only in exceptional situations and could be left to law applicable outside the draft Convention. The Commission may wish to reconsider this matter. Even if fraudulent notifications do not pose a problem in practice, the fact that a debtor could not rely on a prima facie legitimate notification may undermine the certainty necessary for the debtor to obtain a discharge. A rule that would protect a debtor paying in good faith in the case of a "purported assignment" would be consistent with the overall policy to protect the debtor (draft article 12.308 of the European Contract Principles refers to a debtor who performs in good faith and neither knows nor ought to know of such invalidity).

Debtor's discharge and priority/knowledge of superior claims

137. Unlike article 8 (1) of the Ottawa Convention, article 19 does not require the debtor to pay the person with priority so as to obtain a valid discharge. Having agreed that the assignment should not adversely affect the legal position of the debtor, the Working Group drew a clear distinction between the issue of the debtor's discharge and the issue of priority. Thus, payment under article 19 discharges the debtor, even if the person receiving payment does not have priority. It would be unfair and inconsistent with the policy of debtor protection to require the debtor to determine who among several claimants has priority and that the debtor pay a second time if, in the first instance, it has paid the wrong person. The debtor would most likely have a cause of action against that person, but the debtor's rights may be frustrated if that person becomes insolvent. The risk of insolvency of the person who received payment should be on the various claimants of the receivables and not on the debtor. Such claimants would have to settle among themselves their rights in the proceeds of payment in accordance with the law governing priority under the draft Convention.

Multiple notifications

138. Paragraphs (2) and (4) are intended to provide simple and clear discharge rules in the case of several notifications. Paragraph (2) deals with situations in which the debtor receives several notifications relating to more than one assignment of the same receivables by the same assignor ("duplicate assignments"). Such situations do not necessarily involve fraud. They may, for example, involve several outright assignments for security purposes of receivables for credit not exceeding the value of the receivables. In such assignments, the main issue is who will obtain payment first (i.e. who has priority). Paragraph (4) deals with notifications relating to more than one subsequent assignment. Such situations are rare in practice, since normally only the last in a chain of assignees notifies the debtor and requests payment. In any case, in order to avoid any uncertainty as to how the debtor may discharge its debt, paragraph (4) provides that the debtor has to follow the instructions contained in the notification of the last assignment in a chain of assignments. For that rule to apply, the notifications received by the debtor have to be readily identifiable as notifications relating to subsequent assignments. Otherwise, the rule contained in paragraph (2) would apply and the debtor would be discharged by payment in accordance with the first notification received (for a secretariat suggestion in this regard, see para. 132). In any case, under paragraph (5), the debtor, if in doubt, could request adequate proof from the assignees notifying. If the debtor receives several notifications relating to several as-

signments of the same receivables by the same assignor and to subsequent assignments, under a combined application of paragraphs (2) and (4), the debtor is discharged by paying in accordance with the first notification of the last assignment (as to the debtor's discharge in the case of partial subsequent assignments, see paras. 32-34).

Change or correction of payment instructions

139. Paragraph (3) is intended to ensure that the assignee may change or correct its payment instructions. Whether the debtor is notified by the assignor or the assignee, if a new payment instruction is sent with regard to one and the same assignment, the debtor may discharge its debt only in accordance with that instruction. The only condition is that, in line with the policy underlying article 15 (1), subsequent to the notification, a payment instruction be given by the assignee. In order to protect the debtor against the risk of having to pay twice, paragraph (3) expressly provides that a payment instruction received by the debtor after payment is to be disregarded.

Right of the debtor to request additional information

140. Under article 15, notification may be given not only by the assignor but also by the assignee independently of the assignor. As a result, the debtor may receive notification of the assignment from a possibly unknown person and may be in doubt as to whether that person is a legitimate claimant, payment to whom would discharge the debtor. In order to protect the debtor from uncertainty as to how to discharge its debt in such cases, paragraph (5) gives the debtor a right to request the assignee to provide adequate proof of the assignment within a reasonable period of time. Paragraph (5) does not introduce an obligation of the debtor, since requesting additional proof in all cases would unnecessarily delay payment and add to the cost of the notification. The determination of what constitutes "adequate" proof and a "reasonable" period of time is a matter of interpretation for the courts or arbitral tribunals taking into account the particular circumstances. The Working Group thought that the flexibility introduced with these terms was necessary, since no rule could be found that would be suitable for all possible cases. In addition, in order to avoid any uncertainty that might ensue as a result of the use of these terms, the Working Group decided to include a "safe harbour" rule, according to which a written confirmation from the assignor constituted adequate proof (in such a case, under draft article 12.303 of the European Contract Principles, the assignment has to be in writing and the debtor should have a chance to inspect it).

141. The notification does not trigger the obligation to pay, which remains subject to the original contract and the law applicable thereto. This means that the debtor does not have to pay upon notification and does not owe interest for late payment while it awaits the adequate proof requested. If, however, the debt becomes payable within that period in accordance with the original contract, the question arises as to whether the payment obligation is suspended until the debtor receives such proof and has a reasonable time to assess and act on it. If the payment obligation is not suspended, the significance of the protection afforded to the debtor by paragraph (5) may be reduced to the extent that the debtor delaying payment, even for good reasons, would have to pay interest. The Working Group proceeded on the understanding that the payment obligation would be suspended in such cases, but chose not to include any explicit wording in paragraph (5), since that result could be reached, in any event, without any additional wording and such wording could inadvertently interfere with national law on interest.

Debtor's discharge under other law

142. Paragraph (6) is intended to ensure that article 19 does not exclude other ways of discharge of the debtor's obligation that may exist under national law applicable outside the draft Convention (e.g. a notification not conforming with the requirements of article 6 *(f)*, 15 or 18).

Article 20. *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 any other contract that was part of the same transaction, 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.

(3) Notwithstanding paragraphs (1) and (2) of this article, defences and rights of set-off that the debtor may raise pursuant to article 11 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.9/420, paras. 66-68 and 132-135
A/CN.9/432, paras. 205-209
A/CN.9/434, paras. 194-197
A/CN.9/447, paras. 94-102
A/CN.9/456, paras. 194-199
A/CN.9/466, paras. 133-136

Commentary

143. Article 20 is another particular application of the general principle that the debtor's legal position should not be unduly affected as a result of the assignment. The debtor has against the assignee all the defences and rights of set-off that the debtor could raise against the assignor (for an exception, see article 20 (3)). What those defences and rights of set-off are is a matter not addressed in the draft Convention but left to other law. However, the assignee is not a party to the original contract and incurs, therefore, no positive contractual liability for non-performance by the assignor. In such a case, the debtor can raise the non-performance to defeat the assignee's claim, but needs to make a separate claim against the assignor to obtain, for example, compensation for any loss suffered as a result of the assignor's non-performance.

Defences and rights of set-off under the original and related contracts: no limitation

144. Under paragraph (1), the debtor may raise against the assignee all the defences that arise from the original contract, without any limitation, including contractual claims, which, in some legal systems, might not be considered "defences"; rights for contract avoidance, for example, for mistake, fraud or duress; exemption from liability for non-performance, for example, because of an unforeseen impediment beyond the control of the parties; and counterclaims under the original contract. The debtor may also raise defences and rights of set-off arising from contracts between the assignor and the debtor that are closely related to the original contract (e.g. a maintenance or other service agreement supporting the original sales contract) and should be treated in the same way as rights of set-off arising from the original contract. Such defences and rights of set-off may be raised irrespective of whether they are available at the time of notification of the assignment or become available only after such notification.

Other rights of set-off: available up to notification of the debtor

145. Paragraph (2) introduces a time limitation with regard to rights of set-off arising from any source other than the original contract, that is, a separate contract between the assignor and the debtor, a rule of law (e.g. a tort rule) or a judicial or other decision. Such rights may not be raised against the assignee if they become available after notification of the assignment. The rationale underlying this rule is that the rights of a diligent assignee who notifies the debtor should not be made subject to rights of set-off arising at any time from separate dealings between the assignor and the debtor or other events, of which the assignee could not reasonably be expected to be aware. On the other hand, the interests of the debtor are not unduly affected, since, if the fact that the debtor cannot accumulate rights of set-off constitutes an unacceptable hardship for the debtor, the debtor can avoid entering into new dealings with the assignor (on the question whether the debtor could declare the original contract avoided, see paras. 102 and 104). In view of the above-mentioned rationale of paragraph (2), rights of set-off arising from separate contracts between the debtor and the assignee are not affected. Such rights can be asserted against the assignee even after notification of the assignment, like rights of set-off arising from the original contract. It should also be noted that a notification results in freezing the debtor's rights of set-off, whether it contains a payment instruction or not. This approach is intended to accommodate practices in which a bare notification is given exactly for the purpose of precluding the debtor from accruing rights of set-off from acts or omissions of the assignor that are beyond the assignee's control, while the debtor is expected to continue paying the assignor.

"Available"

146. The exact meaning of the term "available" (e.g. whether the right of set-off has to be "actual and ascertained" at the time notification is received by the debtor) is left to other law. The Working Group was not able to agree on introducing such a clarification in the text of article 20, since it considered that it would result in limiting inappropriately the rights of set-off available to the debtor to those which are quantified at the time of the notification. The Working Group was not able to agree on the law governing issues relating to rights of set-off either (see, however, para. 195). The Commission may wish to consider clarifying, at least, that the relevant cross-claim of the debtor does not need to have matured at the time of notification. Otherwise, a debtor's potential cross-claim, due to mature at the same time as the creditor's claim, would be extinguished by the creditor's assignment of its claim. Such a result would run counter to the principle that an assignment should not prejudice the debtor's legal position.

Defences and rights of set-off in the case of breach of a contractual limitation

147. Paragraph (3) is intended to ensure that the debtor may not raise against the assignee by way of defence or set-off the breach of a contractual limitation by the assignor. The debtor may have a cause of action against the assignor, if, under law applicable outside the draft Convention, the assignment constitutes a breach of contract that results in a loss to the debtor. However, the mere existence of a contractual limitation is not a violation of the representation contained in article 14 (1) *(a)*. In the absence of a provision along the lines of paragraph (3), article 11 (2), holding the assignee harmless for breach of contract by the assignor could be deprived of any meaning.

Article 21. *Agreement not to raise defences or rights of set-off*

(1) Without prejudice to the law governing the protection of the debtor in transactions made for personal, family or household purposes in the State in which the debtor is located, the debtor may agree with the assignor in a writing signed by the debtor not to raise against the assignee the defences and rights of set-off that it could raise pursuant to article 20. 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.

(3) Such an agreement may be modified only by an agreement in a writing signed by the debtor. The effect of such a modification as against the assignee is determined by article 22 (2).

References:

A/CN.9/420, paras. 136-144
A/CN.9/432, paras. 218-238
A/CN.9/434, paras. 205-212
A/CN.9/447, paras. 103-121
A/CN.9/456, paras. 200-204
A/CN.9/466, paras. 137-140

Commentary

Waivers of defences agreed between the assignor and the debtor

148. In order to obtain more value for their receivables and at a lower cost, assignors normally guarantee as against assignees the absence of defences and rights of set-off by the debtor. Recognizing this practice, article 14 (1) *(c)* provides that such a guarantee exists even in the absence of an agreement between the parties in this regard. In practice, if such representations cannot be given and the receivables are likely to be subject to defences, such receivables are either not accepted by assignees, or are accepted at a significantly reduced value or only on a recourse basis (i.e. if the assignee cannot collect from the debtors, it has the right to return the receivables to and collect from the assignor). In order to avoid those adverse effects, assignors, as a matter of practice, negotiate with debtors waivers of the defences and rights of set-off that debtors may raise against any future assignee. On the basis of such waivers, assignees determine the credit terms offered to assignors, which in turn are likely to affect the credit terms assignors offer to debtors.

149. With a view to allowing assignors to obtain lower-cost credit, article 21 validates such waivers of defences and rights of set-off. Furthermore, in order to avoid uncertainty as to the legal consequences of a waiver and that a court may override it as being unfair to the debtor or as being enforceable only as between the assignor and the debtor, paragraph (1) states what may appear obvious in some legal systems, namely, that a waiver agreed upon between the assignor and the debtor may benefit the assignee. In recognition of the fact that in practice a waiver may be agreed upon at the time of the conclusion of the original contract, as well as at an earlier or later time, paragraph (1) does not make specific reference to the point of time at which a waiver may be agreed upon. Paragraph (1) does not require either that the defences are known to the debtor or are explicitly stated in the agreement by which the defences are waived. The Working Group thought that such a requirement would introduce an element of uncertainty, since the assignee would need to establish in each particular case what the debtor knew or ought to have known. Whether the acceptance of an assignment by the debtor should be construed as a waiver or as a confirmation of a waiver or whether a waiver of defences is to be construed as a consent or confirmation of the debtor's consent to the assignment is left to other law.

Waivers of defences agreed between the assignor and the debtor

150. Paragraph (1) is limited to waivers agreed upon by the assignor and the debtor. As a result, the limitations contained in paragraph (2) do not apply to waivers agreed upon by the debtor and the assignee. The Working Group thought that the draft Convention should not limit the debtor's ability to negotiate with the assignee in order to obtain a benefit, such as a lower interest rate or a longer payment period. At the same time, the Working Group also thought that, in view of the fact that agreements between assignees and debtors were outside the scope of the draft Convention, the draft Convention should not empower the debtor to negotiate waivers with assignees, if, under the law applicable, the debtor would not have such a power (see para. 75).

Limitations on waivers

151. While aimed at facilitating increased access to lower-cost credit, which is in the interest of trade in general, article 21 does not neglect the protection of the debtor. In order to protect debtors from undue pressure by creditors to waive their defences, paragraphs (1) and (2) introduce reasonable limitations with respect to such waivers of defences. Such limitations refer to the form in which such waivers can be made, to certain types of debtors and to certain types of defences.

152. Under paragraph (1), a waiver cannot be a unilateral act or an oral agreement; it has to take the form of a written agreement signed by the debtor, so as to ensure that both parties, and in particular the debtor who is waiving rights, are well informed about the fact of the waiver and its consequences, including the benefits offered to the debtor in return, and to facilitate evidence. In addition, a waiver cannot override the consumer-protection law prevailing in the country in which the debtor has its place of business (for consumer receivables and consumer protection, see paras. 36, 100, 128 and 196). In cases where the draft Convention applies, this provision in effect substitutes a specific applicable law reference to the debtor's location for the general rule set forth in article 29. In order to avoid terminological and other differences existing among the various legal systems, paragraph (1) refers to debtors in transactions for "personal, family or household purposes". Furthermore, under paragraph (2), a waiver cannot relate to defences arising from fraudulent acts committed by the assignee. Such a result would run counter to basic good faith standards. With a view to protecting an assignee who accepts an assignment in good faith, the Working Group decided not to apply the same limitation to defences relating to fraud by the assignor. If the debtor could not waive such defences, the assignee would have to investigate in order to ensure that no fraud was committed by the assignor in the context of the original contract. The limitation under paragraph (2), however, applies not only to defences relating to fraud by the assignee alone but also to defences relating to fraud by the assignee in collusion with the assignor.

Modifications of waivers

153. In line with paragraph (1), paragraph (3) requires the form of a written agreement signed by the debtor for the modification of a waiver. Parties need to be warned of the legal consequences of such a modification, which should be easily proved, if necessary. With a view to ensuring that a modification, which may be agreed upon by the assignor and the debtor, does not affect the rights of the assignee, paragraph (3) subjects a modification to the procedure foreseen in article 22 (2) for the modification of the original contract after notification of the assignment (i.e. to actual or constructive consent by the assignee; see para. 157).

Article 22. *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.

References:

A/CN.9/420, para. 109
A/CN.9/432, paras. 210-217
A/CN.9/434, paras. 198-204
A/CN.9/447, paras. 122-135
A/CN.9/456, paras. 205 and 206
A/CN.9/466, paras. 141 and 142

Commentary

154. In practice, the original contract may often need to be modified, for various reasons (e.g. equipment or materials different from the ones agreed may be necessary in the construction of a project). The effects of such contract modifications as between the assignor and the debtor, or as between the assignor and the assignee, are addressed in the relevant contract. In recognition of party autonomy in this regard, article 22 does not interfere with the relationship between the assignor and the debtor or between the assignor and the assignee. Accordingly, the requirements and the legal consequences of an effective modification agreement as between the assignor and the debtor remain subject to the law governing that agreement and any rights that the assignee might have against the assignor for breach of contract are not affected (see para. 158). However, article 22 deals with the third-party effects of such contract modifications that may be addressed only by way of legislation and are regulated only in a few jurisdictions. To address those third-party effects, article 22 provides, on the one hand, that the debtor has as against the assignee the right to modify the original contract and, on the other hand, that the assignee acquires rights as against the debtor under the modified original contract. Accordingly, if the price of the goods or services offered under the original contract is modified, the debtor may not raise the modification of the contract as a defence, asserting that the assignee has no rights under the new modified contract, and refuse to pay even the reduced price. Similarly, payment of the reduced price would discharge the debtor's obligation.

155. The basic rule introduced by article 22 is that, before notification, the assignor and the debtor may freely modify their contract. They do not need to obtain the consent of the assignee, even though the assignor may have undertaken in the assignment contract to abstain from any contract modifications without the consent of the assignee or may be under the good faith obligation to inform the assignee about a contract modification. The breach of such an undertaking may give rise to liability of the assignor as against the assignee. It does not, however, invalidate an agreement modifying the original contract, since such an approach would inappropriately affect the rights of the debtor. After notification, a modification of the original contract becomes effective as against the assignee subject only to the actual or constructive consent of the assignee. The underlying rationale is that, after notification, the assignee becomes a party to a triangular relationship and any change in that relationship that affects the assignee's rights should not bind the assignee against its will. This approach is in line with article 19, according to which, before notification, the debtor may discharge its obligation in accordance with the original contract.

Modification before notification of the debtor

156. Paragraph (1) requires an agreement between the assignor and the debtor, which is concluded before notification of the assignment and affects the assignee's rights. If the agreement does not affect the rights of the assignee, paragraph (1) does not apply. If the agreement is concluded after notification, paragraph (2) applies. Under article 18, the relevant point in time is the time when notification is received by the debtor, since as of that time the debtor may discharge its obligation only in accordance with the assignee's payment instructions.

Modification after notification of the debtor

157. Paragraph (2) is formulated in a negative way, since the rule is that, after notification, a modification is ineffective as against the assignee, unless an additional requirement is met. "Ineffective" means that the assignee may claim the original receivable and the debtor is not fully discharged by paying less than the value of the original receivable. Paragraph (2) requires actual or constructive consent of the assignee. Actual consent is required if the receivable has been fully earned by performance and the assignee has thus the reasonable expectation that it will receive payment of the original receivable. For the purposes of the draft Convention, a receivable is considered as being fully earned when an invoice is issued, even if the relevant contract has only partially been performed. As a result, for such partially performed contracts to be modified, the actual consent of the assignee is required. Constructive consent exists if the original contract allows modifications or a reasonable assignee would have given its consent. Such a consent is sufficient if the receivable is not fully earned and the modification is foreseen in the original contract or a reasonable assignee would have consented to such a modification. In requiring actual or constructive consent, the Working Group intended to establish an appropriate balance between certainty and flexibility. If a receivable is fully earned, its modification affects the reasonable expectations of the assignee and has thus to be subject to the actual consent of the assignee. If, on the other hand, a receivable is not fully earned, there is no need to overburden the parties with requirements that may affect the efficient operation of a contract. In particular, in long-term

contracts, such as project financing or debt-restructuring arrangements (in which receivables are offered as security in return for a reduction in the interest rate or an extension of the maturity date), a requirement that the assignor would have to obtain the assignee's consent to every little contract modification could slow down the operations while creating an unwelcome burden for the assignee. This problem would normally not arise, since in practice parties tend to resolve such issues through an agreement as to which types of modifications require the assignee's consent. In the absence of such an agreement or in the case of breach of such an agreement by the assignor, paragraph (2) would provide an adequate degree of protection to the debtor.

Assignor's liability for breach of contract

158. Paragraph (3) is intended to preserve any right the assignee may have under other law as against the assignor if a modification of the original contract violates an agreement between the assignor and the assignee. This means that, if, under article 22, a modification is effective as against the assignee without its consent, the debtor is discharged by paying in accordance with the contract as modified. The assignee, however, may turn against the assignor and claim the balance of the original receivable and compensation for any additional damage suffered, if the modification is in breach of an agreement between the assignor and the assignee under the law applicable to the agreement.

Article 23. *Recovery of payments*

Without prejudice to the law governing the protection of the debtor in transactions made for personal, family or household purposes in the State in which the debtor is located and the debtor's rights under article 20, failure of the assignor to perform the original contract does not entitle the debtor to recover from the assignee a sum paid by the debtor to the assignor or the assignee.

References:

A/CN.9/420, paras. 145-148
A/CN.9/432, paras. 239-244
A/CN.9/434, paras. 94 and 213-215
A/CN.9/447, paras. 136-139
A/CN.9/456, paras. 207 and 208
A/CN.9/466, paras. 143 and 144

Commentary

The rule: no recovery of payments from the assignee

159. In practice, the debtor may pay the assignee before the assignor performs its obligations under the original contract. If the assignee does not perform, the question arises whether the debtor may recover from the assignee the sums paid. This question is of particular importance if the assignor becomes insolvent and thus recovery of payments from the assignor is impossible. Article 23 provides that, if the debtor pays the assignee and the assignor does not properly perform the original contract, the debtor cannot turn against the assignee; it is left with any cause of action it might have against the assignor under the original contract and the law governing that contract. As a result, the debtor bears the risk of insolvency of its contractual partner, which would be the case anyway in the absence of an assignment. Noting that article 10 of the Ottawa Convention follows this approach only if the debtor has a cause of action against the assignor and provides for exceptions in the case of unjust enrichment or bad faith on the part of the assignee, the Working Group thought that the difference was justified. A right of the debtor to recover payments from the assignee operates as a guarantee by the assignee that the assignor will perform the original contract. Such a guarantee may be appropriate in the specific factoring situations addressed in the Ottawa Convention, but was thought to be inappropriate in the context of the wide range of financing or service transactions covered by the draft Convention.

Exceptions

160. In line with the principle that the draft Convention is not intended to override consumer protection law, article 23 preserves any right that the consumer debtor might have, under the law of the country in which it is located, to declare the original contract avoided and to recover from the assignee any payments made to the assignee (for consumer receivables and consumer protection, see paras. 36, 100, 128, 152 and 196). The reference to article 20 appears to introduce a second exception. In the case of payments in instalments, the debtor's defences and rights of set-off with respect to outstanding instalments are preserved. The Commission may wish to consider whether this result is already sufficiently clear in article 20.

Section III. Other parties

Commentary

Structure of section III

161. Articles 24 (law applicable to priority issues) and 25 (public policy) are private international law rules. Article 26 (special proceeds rules) is a mixed private international law and substantive law rule and article 27 (subordination) is a substantive law rule. Articles 25, 26 and 27 are intended to qualify the application of article 24. Article 25 appears before article 26 not because it does not equally apply to situations dealt with in article 26, but because article 26, with respect to private international law matters, refers back to article 24 and, with respect to substantive law matters, it is a self-standing rule. Article 25 is not intended to limit the application of the special substantive law priority rule in article 27.

Article 24. *Law applicable to competing rights of other parties*

With the exception of matters which are settled elsewhere in this Convention, and subject to articles 25 and 26, the law of the State in which the assignor is located governs:

(a) The extent of the right of an assignee in the assigned receivable and the priority of the right of the

assignee with respect to competing rights in the assigned receivable of:

(i) Another assignee of the same receivable from the same assignor, even if that receivable is not an international receivable and the assignment to that assignee is not an international assignment;

(ii) A creditor of the assignor; and

(iii) The insolvency administrator;

(b) The existence and extent of the right of the persons listed in paragraph (1) *(a)* (i) to (iii) in proceeds of the assigned receivable, and the priority of the right of the assignee in those proceeds with respect to competing rights of such persons; and

(c) Whether, by operation of law, a creditor has a right in the assigned receivable as a result of its right in other property of the assignor, and the extent of any such right in the assigned receivable.

References:

A/CN.9/420, paras. 149-164
A/CN.9/432, paras. 245-260
A/CN.9/434, paras. 238-258
A/CN.9/445, paras. 18-29 and 30-40
A/CN.9/455, paras. 18-34
A/CN.9/456, paras. 209-213
A/CN.9/466, paras. 20-24 and 32-35

Commentary

162. Article 24 is one of the most important provisions of the draft Convention. It is intended to serve the main goal of the draft Convention to facilitate increased access to lower-cost credit by enhancing certainty as to the relative rights of competing claimants. This result is achieved not by way of a substantive law priority rule (as to the meaning of the term "priority", see paras. 63-65), since the Working Group was not able to reach consensus on such a rule (for substantive law priority rules, see, however, articles 26 and 27, the annex and article 40). Rather it is achieved by way of a private international law rule subjecting conflicts of priority to the law of a single and easily determinable jurisdiction (the law of the assignor's location; for the meaning of the term "location", see paras. 66-70). Such a rule constitutes a significant improvement of the present situation in which assignees tend either to reject international receivables as security for credit or accept them at a low value or only with additional security, since they either cannot determine which law may govern priority or have to meet the requirements of several jurisdictions in order to ensure priority.

"With the exception of matters which are settled elsewhere in this Convention"

163. The opening words of article 24 are intended to ensure that article 24 would apply only to matters that are not settled by way of a substantive law rule of the draft Convention. For example, the general effectiveness of an assignment of future receivables or notification of the assignment is addressed in article 9; the question whether, in the case of receivables arising or being earned after the commencement of an insolvency proceeding with respect to the assignor, the assignee has priority is left to the law of the assignor's location. As a result, an assignment of a receivable not existing at the time of notification is effective as between the assignor and the assignee. Similarly, an assignment is effective as against the debtor, even in the absence of a notification, and, if national law requires notification for priority reasons, notification has to be given under the draft Convention (it may thus relate to receivables not existing at the time of notification, even if national law does not allow notification with respect to such receivables). Furthermore, an assignment is effective in the absence of registration (even if national law makes registration a condition of effectiveness and requires a specific description of the assigned receivable). However, priority will be determined on the basis of registration, if the law of the assignor's location so provides (whether the receivable needs to be specifically described for the purpose of obtaining priority through registration is left to the law of the assignor's location). Issues of formal validity (e.g. whether a writing, notification or registration is required for the assignment to be effective inter partes) are left to law outside the draft Convention (for a secretariat suggestion to address this matter, see para. 82); as are issues of material validity other than those addressed in articles 9 to 12.

"Subject to articles 25 and 26"

164. The matters mentioned in article 24 are referred to the law of the assignor's location unless a rule of that law is manifestly contrary to the public policy of the forum or there is a super-priority right under the law of the forum. In the former case, the balance of the law of the assignor's location applies. In the latter case, the super-priority right, which under the law of the forum has priority, is given priority. The Commission may wish to consider whether the application of article 24 should also be subject to the absence of a subordination agreement (article 27). Alternatively, the Commission may wish to consider that, in view of the fact that article 27 is a substantive law rule, the opening words of article 24 ("With the exception of ...") are sufficient to cover matters settled in article 27 (although article 26 is also a substantive law rule and the application of article 24 is made subject to article 26).

Extent of a right and priority in receivables

165. Article 24 *(a)* draws a clear distinction between priority and the extent of the assignee's rights. The words "extent of a right" are intended to reflect whether an assignment by way of security or an outright assignment is involved and the in rem or ad personam nature of a right as against third parties (the proprietary effects of an assignment as between the assignor and the assignee are settled in article 9). Priority, on the other hand, deals with the question of who obtains payment first. In a conflict between a claimant with priority, who has a personal right, and a claimant, with a right in rem, the claimant with priority will prevail. However, in the case of insolvency, such a prevailing claimant would be paid pari passu with other creditors with a personal right, while it would be paid before those creditors if it had a right in rem.

Conflicts between assignees in the case of duplicate assignments

166. Conflicts between assignees of the same receivables from the same assignor arise in the case of "duplicate assignments". Such assignments are normal practice in the case of assignments by way of security in which the same receivables are offered to different lenders as security for various amounts of credit. However, duplicate outright assignments may be a fraudulent or an unconscionable act. While fraud may be a rare occurrence, simple inadvertence on the part of the assignor, or ignorance of the legal effects of a previous assignment, occurs frequently. A typical example is the assignment to a receivables financier in return for working capital and to an inventory financier or to a supplier of materials on credit with a retention of title or other security interest until full payment of the price of the inventory or of the materials. In such a case, the conflict may be between a global assignment (an assignment of all present and future receivables) to the receivables financier and an assignment to the inventory financier or the supplier of the proceeds from the sale of the inventory or materials.

Conflicts between Convention and non-Convention assignees

167. Article 24 *(a)* (i) explicitly provides that a conflict between a Convention and a non-Convention assignee (e.g. between a foreign and a domestic assignee of domestic receivables) is also covered (however, a conflict between an assignee in a Contracting State and an assignee in a non-Contracting State is not covered). Such an approach avoids any negative impact on domestic law and practice. In fact, one of the reasons for which the Working Group decided to turn the priority rules into private international law rules was that such rules would not negatively affect domestic practices. The draft Convention does not give priority to a foreign assignee over a domestic assignee. It merely refers conflicts of priority to the law of the assignor's location. With one possible exception (see para. 20), that law would be the law the requirements of which the domestic assignee of a domestic receivable would have to meet to obtain priority, whether the draft Convention applies or not.

Conflicts with the assignor's creditors or the insolvency administrator

168. A creditor of the assignor or the insolvency administrator may have a competing right with the assignee, if, after the assignment, that creditor obtains a court judgement attaching the receivables in the hands of the assignor (if the assignment is made after attachment or the commencement of an insolvency proceeding, no conflict arises; any rights that the assignee may obtain are subordinate to the rights of the assignor's creditors or the insolvency administrator). If priority is based on the time of assignment, the fact that the assignment is made before attachment or commencement of the insolvency proceeding is sufficient to establish that the receivables are separated from the assignor's estate (if an outright assignment is involved) or that the assignee may satisfy its claim in preference to unsecured creditors (if an assignment by way of security is involved). If, however, priority is determined on the basis of notification of the debtor or registration of certain data about the assignment in a public registry, the fact that the assignment is made before attachment or commencement of the insolvency proceeding is not sufficient for the purpose of establishing priority. Notification of the debtor or registration also needs to take place before attachment or commencement of the insolvency proceeding.

Insolvency of the assignee or the debtor

169. Issues arising in the case of insolvency of the assignee are beyond the scope of the draft Convention and are not addressed, unless the assignee makes a subsequent assignment and becomes an assignor. The draft Convention is not intended to address issues arising in the context of the debtor's insolvency either. It is assumed that the assignee would have in the receivables the same rights that the assignor would have in the case of insolvency of the debtor.

"The existence and extent of the right ... and the priority of a right" in proceeds

170. In line with subparagraph *(a)*, subparagraph *(b)* provides that the law of the assignor's location governs the extent of the rights of the persons mentioned above and the priority of such rights with respect to proceeds. Proceeds include, under article 6 *(k)*, proceeds of receivables and proceeds of proceeds. Therefore, the words "of the assigned receivable" may need to be deleted, so as to avoid creating the impression that only proceeds of receivables are covered in article 24 *(b)*. The words "the extent of the right" relate to the in rem or ad personam nature of the assignee's rights in proceeds. The Commission may wish to consider whether the word "existence", which was added at the thirty-first session of the Working Group without any discussion, should be retained (see A/CN.9/466, para. 212). It would seem that subparagraph *(b)* goes far beyond subparagraph *(a)*, in that it covers, with respect to proceeds, issues that the draft Convention does not address even with respect to receivables, namely, substantive validity in every respect and formal validity matters. If article 24 *(b)* is retained unchanged, the title of the article may need to be revised.

The existence and the extent of rights in receivables that are proceeds of other property

171. The extent of any rights and the priority of such rights in receivables that are proceeds of other receivables is subject to the law of the assignor's location by virtue of article 24 *(a)* (i), if such rights are created by agreement, or by virtue of article 24 *(a)* (ii), if such rights are created by operation of law. Depending on whether the Commission decides to retain the reference to the "existence" of such rights, it may wish to merge subparagraph *(c)* into subparagraph *(a)* (ii) or to delete subparagraph *(c)* altogether and include a clarification of the matter in the commentary (for the meaning of the words "the extent of the right", see para. 165).

Applicable law

172. Departing from the approach traditionally followed in many legal systems, subjecting priority issues to the lex situs of the receivable (the law of the country where payment is due or the debtor is located), the Working Group

decided to subject priority issues to the law of the assignor's location. The Working Group took this approach, considering that the traditional rule is no longer regarded as a workable or efficient rule. In the increasingly common case of a global assignment of present and future receivables, application of the law of the situs of the receivable fails to yield a single governing law. It also exposes prospective assignees to the burden of having to determine the notional situs of each receivable separately. Application of the law governing the receivable or of the law chosen by the parties produces similar results. Different priority rules would govern priority with regard to the various receivables in a pool of receivables and, in the case of future receivables, the parties would not be able to determine with any certainty the law applicable to priority, a factor that might defeat a transaction or, at least, raise the cost of credit. Application of the law chosen by the assignor and the assignee in particular could allow the assignor, acting in collusion with a claimant in order to obtain a special benefit, to determine the priority among several claimants. In addition, the law chosen by the parties would be completely unworkable in the case of several assignments of the same receivables either by the same or by different assignees, since different laws could apply to the same priority conflicts.

173. While the Working Group decided to depart from the traditional approach in order to accommodate the most common practices that involve bulk assignments of all present and future receivables, it decided that no exception should be made for assignments of single, high-value, existing receivables. It was widely felt that introducing a different priority rule with regard to the assignment of such receivables would detract from the certainty achieved in article 24. In addition, it would be very difficult to clearly define "high-value receivables". Moreover, in a bulk assignment containing both "high-value"and "low-value" receivables, priority would be subject to different laws.

174. In view of the fact that, in the case of more than one place of business, location is defined by reference to the place of central administration of a legal entity, application of the law of the assignor's location will result in the application of the law of a single jurisdiction and one that can be easily determined at the time of the assignment. It will thus eliminate the difficulties mentioned above. In particular, the location of the assignor as a connecting factor presents the advantage that it provides a single point of reference; it can be ascertained at the time of even a bulk assignment of future receivables; it would be suitable even for legal systems in which registration is practised; and it would result in the application of the law of the jurisdiction in which any main insolvency proceeding with regard to the assignor would be most likely to commence. This last aspect of the application of the law of the assignor's location is essential, since it appropriately addresses the issue of the relationship between the draft Convention and the applicable insolvency law.

175. With respect to insolvency, the thrust of article 24 is to ensure that, in most cases, the law governing priority under article 24 and the law governing the insolvency of the assignor are the laws of one and the same jurisdiction (the assignor's main jurisdiction). In such a situation, any conflict between the draft Convention and the applicable insolvency law would be resolved by the rules of law of that jurisdiction. In all other cases in which an insolvency proceeding with regard to the assets and affairs of the assignor is commenced in a State other than the State of the assignor's main jurisdiction (e.g. a jurisdiction in which the assignor has assets), the draft Convention gives way to rules of law that reflect the public policy of the State in which a dispute is adjudicated (article 25). Other special rights of the assignor's creditors or the insolvency administrator are not affected (see para. 182).

176. The Commission may wish to consider whether the application of the law of the assignor's location to priority issues in the case of receivables arising from deposit, securities or commodities accounts would be appropriate. In such practices, priority issues are normally subject to the law of the financial service provider's location. Introducing a different priority rule with regard to such practices may be in line with the normal expectations of parties. On the other hand, such an approach may introduce uncertainty, at least, to the extent that parties, in order to determine which priority rule applies, would need to discover the source of the assigned receivables, which would not be possible with respect to future receivables and would only be possible at some cost with respect to receivables assigned in bulk.

Limitations of applicable law rules

177. As a private international law provision, article 24 does not settle priority conflicts; it merely refers them to the law of the assignor's location. If, under that law, priority is based on the time of assignment, an assignee considering whether to finance certain receivables has to rely on the assignor's representations and possibly on representations made by other parties or on information available in a certain market. If the applicable law determines priority based on priority in notification of the debtor, again a prospective assignee has to rely on representations by the assignor and by the debtor, as well as on information available from other sources. In such jurisdictions, priority with regard to future receivables will not be obtainable at all at the time of assignment (at that time the identity of the debtors is not known), and priority with regard to receivables assigned in bulk will only be obtainable at the additional cost of notifying all the debtors. If, on the other hand, under the law applicable, priority is obtained by way of making certain data part of a public record, beyond representations by the assignor or other parties, prospective assignees would have that public record to rely on. In addition, assignees filing the required data would have an objective way of acquiring priority (for additional limitations to the application of the priority rules of the draft Convention, see paras. 177-180).

Time relevant for the determination of the location of the assignor

178. For the draft Convention, including article 24, to apply, the assignor has to be located in a Contracting State at the time of the conclusion of the contract of assignment. This approach enhances predictability as to the application of the draft Convention and facilitates decisions as to entering into and establishing the cost of a transaction. How-

ever, if the assignor makes an assignment in one country and another assignment in another country to which the assignor relocates, the draft Convention may not apply if the new location of the assignor is not in a Contracting State (article 24 *(a)* (i) is not intended to cover such situations) and, even if the draft Convention applies, the application of article 24 would be problematic since there would be two laws of the assignor's location. The Commission may, therefore, wish to consider that, in the case of relocation of the assignor or the receivable, a grace period should be introduced, during which the assignee with priority under the law of the initial location would not lose its priority. Such an approach would ensure that the rights of claimants in the new location would not for ever be subject to the rights of claimants from other jurisdictions. Such a transition rule would be necessary, since, with the current pace of mergers, moving the place of central administration of an entity may not be a rare occurrence. Dealing with the issue of relocation would be necessary, in particular, if location of an entity is defined by reference to the place where a receivable is booked. Moving receivables is certainly easier than moving places of central administration.

Article 25. *Public policy and preferential rights*

(1) The application of a provision of the law of the State in which the assignor is located may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.

(2) In an insolvency proceeding commenced in a State other than the State in which the assignor is located, any preferential right that arises under the law of the forum State and is given priority status over the rights of an assignee in insolvency proceedings under the law of that State has such priority notwithstanding article 24. A State may deposit at any time a declaration identifying those preferential rights.

References:

A/CN.9/434, paras. 216-237
A/CN.9/445, paras. 41-44
A/CN.9/455, paras. 35-40
A/CN.9/456, paras. 214-222
A/CN.9/466, paras. 36-41

Commentary

Public policy

179. The policy underlying article 25 is to strike a balance between the need to ensure certainty as to the application of the law of the assignor's location and the need to preserve the fundamental policy decisions of the law of the forum. Accordingly, paragraph (1) recognizes the right of a court or other authority, whether in the context of insolvency or not, to set aside a provision of the law of the assignor's location and, at the same time, limits that right to cases in which that provision is "manifestly contrary" to the public policy of the forum State. The public policy meant in paragraph (1) is the international public policy of the forum State. Recourse to such public policy has only a negative effect in the sense that it may defeat the application of a provision of the law applicable under article 24 that is manifestly contrary to the public policy of the forum State (e.g. a rule giving priority to a foreign State for taxes). As a result, a certain person may be by-passed in the determination of priority, while priority will be determined by other provisions of the applicable law.

180. For a priority rule to be set aside under paragraph (1), it must be "manifestly contrary" to the public policy of the forum State. It is assumed that two jurisdictions are involved (i.e the forum is in a State other than that of the assignor's location). If only one jurisdiction is involved, the rules of that jurisdiction would resolve the matter. The notion of "manifestly contrary" is used in international texts as a qualification of public policy (see, e.g. article 6 of the UNCITRAL Model Law on Cross-Border Insolvency, article 16 of the Rome Convention and article 18 of the Mexico City Convention). The purpose of such a qualification is to emphasize that public policy exceptions should be interpreted restrictively and paragraph (1) should be invoked only in exceptional circumstances concerning matters of fundamental importance for the forum State. Otherwise, the certainty achieved by article 24 could be seriously compromised, a result that would have a negative impact on the availability and the cost of credit on the basis of receivables (the term "manifestly contrary" is used also in article 32; see para. 199).

181. As mentioned above, the public policy of article 25 may not have a positive effect; it may not result in the positive application of a priority rule of the forum State that reflects public policy (e.g. a rule giving priority to employees in the forum State). For that reason, paragraph (2) specifically allows the forum State to apply its own priority rules, in the case where a priority rule applicable under paragraphs (1) and (2) is manifestly contrary to the forum's public policy, and to give priority to super-priority rights reflecting the forum's public policy (e.g. claims of the State for taxes or of employees for wages, but not security rights arising by contract or other property rights recognized in a court judgement). Paragraph (2) goes a step further. It allows (but creates No obligation for) a State to list in a declaration the super-priority rights that should prevail over the rights of an assignee under the draft Convention. This possibility for declarations is intended to enhance certainty in that it provides a mechanism for assignees to know which super-priority rights would prevail over their rights. The Commission may wish to reconsider the use of the term "preferential" (it may be broader than intended and confused with normal priority, which is defined in article 6 *(h)* as a preference).

Special insolvency rights

182. Article 25 makes no reference to special rights of creditors of the assignor or of the insolvency administrator that may prevail over the rights of an assignee under law governing insolvency. The reason is that priority established under the draft Convention is not intended to interfere with such special rights. Such special rights include, but are not limited to, 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 assign-

ment as a fraudulent or preferential transfer. They also include any right of the insolvency administrator 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; 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; to encumber the assigned receivables with the expenses of the insolvency administrator in performing the original contract; or 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. If the assigned receivables constitute security for indebtedness or other obligations, the special rights protected include any rights existing under insolvency rules or procedures generally governing the insolvency of the assignor that permit the insolvency administrator to encumber the assigned receivables; provide for a stay of the right of individual assignees or creditors of the assignor to collect the receivables during the insolvency proceeding; permit the substitution of the assigned receivables for new receivables of at least equal value; or provide 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.

Article 26. *Special proceeds rules*

(1) If proceeds of the assigned receivable are received by the assignee, the assignee is entitled to retain those proceeds to the extent that the assignee's right in the assigned receivable had priority over competing rights in the assigned receivable of the persons described in subparagraph *(a)* (i) to (iii) of article 24.

(2) If proceeds of the assigned receivable are received by the assignor, the right of the assignee in those proceeds has priority over competing rights in those proceeds of the persons described in subparagraph *(a)* (i) to (iii) of article 24 to the same extent as the assignee's right had priority over the right in the assigned receivable of those persons if:

(a) The assignor has received the proceeds under instructions from the assignee to hold the proceeds for the benefit of the assignee; and

(b) The proceeds are held by the assignor for the benefit of the assignee separately and are reasonably identifiable from the assets of the assignor, such as in the case of a separate deposit account containing only cash receipts from receivables assigned to the assignee.

References:

A/CN.9/447, paras. 63-68
A/CN.9/456, paras. 160-167
A/CN.9/466, paras. 42-53

Commentary

183. Article 26 is intended to introduce a limited substantive law priority rule with respect to proceeds. Proceeds include proceeds of proceeds (the words "of the assigned receivable" may, therefore, need to be deleted), but not returned goods (as between the assignor and the assignee, rights in proceeds and returned goods are settled in article 16 (1) *(c)*).

Proceeds received by the assignee

184. Under paragraph (1), the assignee may retain any proceeds received by the assignee (in other words, the assignee has a right in rem), if the assignee has priority with respect to the assigned receivable. The implicit limitation, which may need to be stated explicitly (as in article 16 (3)), is that the assignee may not retain more than the value of its receivable. Paragraph (1), however, may inadvertently result in granting an assignee priority with respect to proceeds of proceeds even if another person has priority with respect to proceeds of the assigned receivable under the law of the assignor's location. For example, if the debtor pays the assignor with a cheque, the assignor deposits the cheque in its bank account and then pays the assignee, under paragraph (1), the first assignee has a right to retain the cash (proceeds of proceeds) even if the depositary institution has priority in the balance in the deposit account (proceeds of the assigned receivable). The same inappropriate result may arise if the assignor receives payment by way of a security (e.g. a bond), the security is pledged to a second assignee and then its proceeds are paid to the first assignee. The first assignee could retain the proceeds of proceeds, even though the second assignee would normally have priority with respect to the proceeds of the assigned receivable under the law of the assignor's location. The Commission may, therefore, wish to introduce language in article 26 to ensure that an assignee's right in proceeds of proceeds does not affect the rights of another person in proceeds of the assigned receivable under the law of the assignor's location.

Proceeds received by the assignor

185. Under paragraph (2), the assignee has priority with respect to proceeds received by the assignor, if it has priority with respect to the assigned receivable and if the assignor receives payment on behalf of the assignee and keeps those proceeds separated from its own assets. This limited provision is aimed at facilitating practices, such as undisclosed invoice discounting and securitization, to the extent that such priority with respect to proceeds will increase certainty as to payment to the assignee, in particular in the case of insolvency. The Commission may wish to consider whether paragraph (2) is sufficient to achieve its objectives, since it does not clearly refer the extent of a right (i.e. its in rem or ad personam nature) to the law of the assignor's location, as does article 24 (the in rem nature and the priority of a right are two distinct issues; see para. 165).

Article 27. *Subordination*

An assignee entitled to priority may at any time subordinate unilaterally or by agreement its priority in favour of any existing or future assignees.

References:

A/CN.9/445, para. 29
A/CN.9/455, para. 31
A/CN.9/456, para. 210

Commentary

186. Article 27 is intended to recognize the interest of the parties, involved in a conflict in negotiating and relinquishing priority in favour of a subordinate claimant where commercial considerations so warrant. In order to afford maximum flexibility and to reflect prevailing business practices, article 27 makes it clear that a valid subordination need not take the form of a direct subordination agreement between the assignee with priority and the beneficiary of the subordination agreement. It can also be effected unilaterally, for instance, by means of an undertaking of the first ranking assignee to the assignor (whether in the contract of assignment or an independent, written or oral, agreement), empowering the assignor to make a second assignment ranking first in priority. The term "unilaterally" is further intended to clarify that the beneficiary of the subordination (the second assignee) need not offer consideration in exchange for the priority granted by the unilateral subordination. Furthermore, article 27 clarifies that an effective subordination need not specifically identify the intended beneficiary or beneficiaries ("any existing or future assignees") and can instead employ generic language. Such unilateral subordination may take place in an assignment between entities in the same corporate group or may be a service offered by a lender to a borrower for commercial considerations.

CHAPTER V. CONFLICT OF LAWS

References:

A/CN.9/420, paras. 185-187
A/CN.9/445, paras. 52-55
A/CN.9/455, paras. 67-73
A/CN.9/466, paras. 145-149

Scope and purpose of chapter V

Commentary

187. Chapter V is intended to state a few general principles that are widely adopted but not recognized in all legal systems. It is not intended to deal with all assignment-related issues in an exhaustive way, or to displace or to contradict any existing international legislative text. Articles 28, 29, 31 and 32 reflect generally accepted principles (e.g. the Mexico City Convention or article 12 of the Rome Convention, with the exception of the requirement for an express choice in article 28 (1) and the rebuttable presumption in favour of the assignor's location in article 28 (2)). The fact that those principles may already be accepted in the law of some States does not reduce their usefulness for other States. Furthermore, in the absence of those provisions, a great degree of uncertainty would remain with regard to the law applicable to all those issues that are left, by necessity, to law other than the draft Convention (for a non-exhaustive list of those issues, see para. 79).

188. Article 30, which is intended to extend the application of the principles embodied in articles 24 to 26 to transactions falling outside the ambit of the draft Convention, breaks new ground in addressing an issue that is not clearly or appropriately resolved in current law. In this respect, the Working Group carefully considered article 12 of the Rome Convention and concluded that, in view of the uncertainty as to whether article 12 covers priority issues and, if it does, as to which is the applicable law, it is necessary to address this matter in the draft Convention. The basic premise of article 30, namely, that priority issues are to be referred to the law of the assignor's location, has been adopted by consensus in articles 24 to 26. The question pending relates to the exact scope of this rule. While chapter V seems to be more or less acceptable in substance, it appears to be objectionable to some States for general legislative policy reasons (relating, e.g. to the questions whether it is good policy to have general private international law rules in a primarily substantive law text, whether UNCITRAL is the appropriate body to prepare private international law rules or whether that matter should be left to other international or regional organizations). In order to address those policy concerns, chapter V has been made subject to an opt-out. The deletion of chapter V or the limitation of its scope, however, would reduce the benefits to be derived from it by States that need it, without providing any additional protection to States that do not need it. Similarly, making chapter V subject to an opt-in could inadvertently result in limiting its scope of application, since an opt-in approach might discourage States from adopting chapter V.

189. As a matter of drafting, the Commission may wish to consider whether article 1 (3), specifying the scope of chapter V and providing for an opt-out by States, should be placed at the beginning of chapter V, along with a provision dealing with the hierarchy between the substantive and the private international law provisions of the draft Convention (see para. 22). The Commission may also wish to consider whether the title of chapter V should be revised to read along the following lines: "Other conflict-of-laws rules" (articles 24 to 26 are also conflict-of-laws rules). Alternatively, the Commission may wish to place all conflict-of-laws rules in one chapter. If such an approach were to be adopted, article 30 could be deleted and articles 24 to 26 would need to be made subject to an opt-out but only to the extent they would apply irrespective of whether the assignor was located in a Contracting State.

Article 28. *Law applicable to the rights and obligations of the assignor and the assignee*

(1) [With the exception of matters that are settled in this Convention,] the rights and obligations of the assignor and the assignee under the contract of assignment are governed by the law expressly chosen by the assignor and the assignee.

(2) In the absence of a choice of law by the assignor and the assignee, their rights and obligations under the contract

of assignment are 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 contract of assignment is presumed to be most closely connected with the State in which the assignor has its place of business. If the assignor has more than one place of business, reference is to be made to the place of business most closely connected to the contract. If the assignor does not have a place of business, reference is to be made to the habitual residence of the assignor.

(3) If the contract of assignment is connected with one State only, the fact that the assignor and the assignee have chosen the law of another State does not prejudice the application of the law of the State with which the assignment is connected to the extent that that law cannot be derogated from by contract.

References:

A/CN.9/420, paras. 188-196
A/CN.9/445, paras. 52-74
A/CN.9/455, paras. 67-119
A/CN.9/466, paras. 150-153

Commentary

190. Article 28 is intended to reflect the principle of party autonomy with respect to the law applicable to the contract of assignment (a principle reflected in articles 12 of the Rome Convention and 7 of the Mexico City Convention). While being widely recognized, this principle is not universally accepted. Pending final determination by the Commission of the exact scope of chapter V, the opening words of article 28 appear within square brackets (if the suggestion made by the secretariat in para. 23 is adopted, these words could be deleted). Paragraph (1) provides that the choice of law must be express. The Working Group recognized that an implicit choice would be in line with current trends in private international law (see articles 3 (1) of the Rome Convention and 7 of the Mexico City Convention). However, it was widely felt that a an express choice should be required in the case of financing transactions, in which certainty was of utmost importance and might determine whether a transaction would take place and at what cost. The Commission may wish to reconsider this matter. It would appear that validating a choice of law that could be "clearly implied from the contract" would not seriously compromise certainty, while it would make article 28 more acceptable to some States.

191. Under paragraph (1), the proper law of the contract governs the purely contractual aspects of the contract of assignment (e.g. conclusion and the substantive validity, the interpretation of its terms, the assignee's obligation to pay the price or to render the promised credit, the existence and effect of representations as to the validity and enforceability of the debt). Paragraph (1), however, is not intended to cover the substantial validity aspects addressed in the draft Convention with respect to assignments falling within its ambit (this is the purpose of the opening words) or other substantive validity aspects, such as capacity or authority to act. The issue is important, since, in some countries, the capacity to effect a bulk assignment is confined to corporations or to assignments made in the course of business of the assignor. It is not sufficiently clear whether article 9 would override such statutory prohibitions relating to capacity. Nor is it clear which law would apply to such statutory prohibitions. While most assignments under the draft Convention should be made by assignors in the course of business, leaving this matter unaddressed leaves a residual area of uncertainty (for a suggestion by the secretariat to address the question of the law applicable to statutory assignability, see para. 196). Paragraph (1) is not intended to cover the financing contract either, if the contract of assignment is just a clause in the financing contract, unless the parties agree otherwise. Furthermore, paragraph (1) does not cover the proprietary aspects of assignment (for this reason, reference is made to "the contract of assignment" as opposed to "the assignment" itself; for this distinction, see paras. 24 and 25). The Working Group agreed that it would not be appropriate to submit the transfer of property rights to the proper law of the contract. With respect to assignments falling within the ambit of the draft Convention, such proprietary aspects are, to a large extent, dealt with in the provisions of the draft Convention outside chapter V.

192. Paragraph (2) is intended to deal with the exceptional situations in which the parties have not expressly agreed on the law applicable to the contract of assignment or in which the parties have agreed but their agreement is later found to be invalid. It refers to the closest-connection test, which may result in the application of the law of the assignor's location (e.g. in the case of an assignment by way of sale) or of the law of the assignee's location (e.g. in an assignment by way of security made in the context of a credit transaction). In an attempt to combine flexibility with certainty, paragraph (2) introduces a rebuttable presumption that the State with the closest connection to the contract is the law of the assignor's location. Location in this context means place of business. In view of the limited scope of application of paragraph (2), the Working Group thought that such a reference to the place of business would not undermine the certainty necessary for financing transactions. In creating a specific presumption in favour of the law of the assignor's location, article 28 is not necessarily in conflict with the practice followed in other private international law texts that refer, for example, to the place where the party who is to effect the characteristic performance has its habitual residence or place of business (article 4 (2) of the Rome Convention) or to "all subjective and objective elements of the contract" (article 9 of the Mexico City Convention). Such conflicts could arise in those cases in which application of the characteristic-performance test would not yield a presumption in favour of the law of the assignor's location. In complex financing transactions, however, where the payment of money and the provision of services or reciprocal obligations are involved, the characteristic-performance test may not be as effective in determining the most closely connected law in any realistic sense. In any case, the parties can select the applicable law. Furthermore, the presumption may be rebutted if the circumstances show that the contract is more closely connected with another country.

193. Paragraph (3) is intended to restrict party autonomy in the sense that the parties to a purely domestic contract

may not set aside the mandatory rules of the law of the State with which the contract is connected. If the contract is not purely domestic, restrictions to party autonomy are to be found in articles 31 and 32. If chapter V is to apply to international assignments or to assignments of international receivables as defined in chapter I, the scope of this rule would be limited to cases where a domestic assignment of a domestic receivable may fall within the ambit of the draft Convention (i.e. in the case of a subsequent assignment in a chain of assignments in which a prior assignment is governed by the draft Convention). Even if chapter V applies independently of chapter I, its scope would be limited, since there would always need to be an international element for the application of private international law provisions to be triggered in the first place. The international element could relate to the contract of assignment as such or to the assigned receivable. The Commission may wish to consider whether this matter should be explicitly clarified in paragraph (3) (e.g. article 3 (3) of the Rome Convention refers, not only to "the contract", but to "all elements relevant to the situation at the time of the choice of a foreign law"). The Commission may also wish to consider whether paragraph (3) should refer consistently to the connection between a State and the contract of assignment (and not the assignment).

Article 29. *Law applicable to the rights and obligations of the assignee and the debtor*

[With the exception of matters that are settled in this Convention,] the law governing the receivable to which the assignment relates determines the enforceability of contractual limitations on assignment, the relationship between the assignee and the debtor, the conditions under which the assignment can be invoked against the debtor and any question whether the debtor's obligations have been discharged.

References:

A/CN.9/420, paras. 197-200
A/CN.9/445, paras. 65-69
A/CN.9/455, paras. 92-104 and 117
A/CN.9/466, paras. 154-158

Commentary

194. In line with the approach that an assignment should not change the legal position of the debtor, article 29 refers issues arising in the context of the relationship between the assignee and the debtor to the law governing the receivable. The proper law of the original contract is meant, not the notional lex situs of the debt. The Commission may wish to clarify this matter explicitly in article 29 (and in article 1 (2)). Such an approach would be justified, since, unlike article 12 (2) of the Rome Convention on which article 29 was modelled and which may apply to non-contractual rights, article 29 covers only contractual receivables. The Working Group decided to avoid specifying how the proper law of the original contract should be determined. It was widely felt that such elaborate rules were not necessary in a chapter that was intended to establish some general rules, without addressing all assignment-related private international law issues. It was also generally thought that it would be inappropriate to attempt to determine the law governing the wide variety of contracts that might be at the origin of a receivable (e.g. contracts of sale, insurance contracts or contracts relating to financial markets operations). Pending final determination by the Commission of the exact scope of chapter V, the opening words of article 29 appear within square brackets (if the secretariat suggestion in para. 23 is adopted, these words could be deleted).

195. It would appear that article 29 also applies to transaction set-off (i.e. a cross-claim arising out of the original contract or a related contract), since a transaction set-off would fall either under the "relationship between the assignor and the debtor" or "the conditions under which the assignment can be invoked against the debtor". The Commission may wish to clarify this matter. Independent set-off (i.e. claims arising from sources that are unrelated to the original contract), however, is not covered. Such claims may arise from a variety of sources (e.g. a separate contract between the assignor and the debtor, a rule of law or a judicial or arbitral decision). Their availability and the conditions governing availability (e.g. liquidity, same currency and maturity) are left to other law. The Working Group considered the law governing the original contract or the contract from which a contractual independent right of set-off might arise, but was unable to reach consensus.

196. Article 29 also covers contractual, but not statutory, assignability as an issue relating to payment by and discharge of the debtor. As a result, in cases where the debtor's rights and obligations are governed by the draft Convention, the assignment is effective as against the debtor, even if there is a limitation on assignment in the original contract (article 11 (1)) and the debtor will not have a defence as against the assignee (article 20 (3)). If the draft Convention does not apply with regard to the debtor, the effects of a contractual limitation on the relationship between the assignee and the debtor are left to the law governing the receivable. The term "enforceability" is intended to reflect both the effectiveness of a contractual limitation both as between the parties thereto and as against third parties (i.e. to validity inter partes and effectiveness erga omnes). For consistency reasons and in order to avoid questions of interpretation (the term "enforceability" appears to exclude the notion of validity inter partes), the Commission may wish to consider substituting the term "effectiveness" for the term "enforceability". The Commission may wish to reconsider the issue of the law applicable to statutory assignability. The law of the assignor's location or the law governing the receivable may be considered. The restriction as to the mandatory rules or the public policy of the forum would be sufficient to ensure that the applicable law would not apply to cases to which it should not apply (e.g. the law governing the receivable may not be appropriate in the case of statutory prohibitions aimed at protecting the assignor). Article 29 does not refer consumer-protection issues to the law of the debtor's location. Article 31, which gives a court the discretion to apply any mandatory rules of the forum or of a closely connected law, should be sufficient to preserve the application of con-

sumer-protection law (for consumer receivables and consumer protection, see paras. 36, 100, 128, 152 and 160).

[Article 30. *Law applicable to competing rights of other parties*

(1) The law of the State in which the assignor is located governs:

(a) The extent of the right of an assignee in the assigned receivable and the priority of the right of the assignee with respect to competing rights in the assigned receivable of:

(i) Another assignee of the same receivable from the same assignor, even if that receivable is not an international receivable and the assignment to that assignee is not an international assignment;

(ii) A creditor of the assignor; and

(iii) The insolvency administrator;

(b) The existence and extent of the right of the persons listed in paragraph (1) *(a)* (i) to (iii) in proceeds of the assigned receivable, and the priority of the right of the assignee in those proceeds with respect to competing rights of such persons; and

(c) Whether, by operation of law, a creditor has a right in the assigned receivable as a result of its right in other property of the assignor, and the extent of any such right in the assigned receivable.

(2) The application of a provision of the law of the State in which the assignor is located may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.

(3) In an insolvency proceeding commenced in a State other than the State in which the assignor is located, any preferential right which arises under the law of the forum State and is given priority status over the rights of an assignee in insolvency proceedings under the law of that State has such priority notwithstanding paragraph (1) of this article. A State may deposit at any time a declaration identifying those preferential rights.]

References:

A/CN.9/445, paras. 70-74
A/CN.9/455, paras. 105-110
A/CN.9/466, paras. 159 and 160

Commentary

197. Like articles 31 and 32, article 30 appears within square brackets pending determination by the Commission of the scope or purpose of chapter V. Retention of article 30 is meaningful only if chapter V is to apply to transactions beyond those falling within the scope of the draft Convention under chapter I. If chapter V has the same scope as the other parts of the draft Convention, article 30 repeats rules reflected in articles 24 to 27 and may thus be deleted. If chapter V is to apply irrespective of chapter I, article 30 would need to be retained. In addition, article 30 may need to specify that it applies also to conflicts involving a subsequent assignment as if the subsequent assignee is the initial assignee (this matter is addressed in chapter I, article 2 *(b)*). Furthermore, paragraph (2) may be deleted as superfluous, since the matter dealt with in paragraph (2) is addressed in article 32. As a private international law rule, article 30 has the goal of providing certainty with regard to the law applicable to conflicts of priority. Such certainty is dependent upon making reference to the law of a single and easily determinable jurisdiction (see paras. 172-176). Priority is defined in article 5 *(i)* as a preference (in payment or other discharge) and article 30 specifies the parties between which such conflicts may arise. In view of the fact that the debtor is not one of those parties, priority does not relate to the debtor's discharge. Therefore, the debtor being discharged under the law governing the receivable cannot be asked to pay again the party with priority under the law of the assignor's location.

[Article 31. *Mandatory rules*

(1) Nothing in articles 28 and 29 restricts the application of the rules of the law of the forum State in a situation where they are mandatory irrespective of the law otherwise applicable.

(2) Nothing in articles 28 and 29 restricts the application of the mandatory rules of the law of another State with which the matters settled in those articles have a close connection if and in so far as, under the law of that other State, those rules must be applied irrespective of the law otherwise applicable.]

References:

A/CN.9/455, paras. 111-117
A/CN.9/466, paras. 161 and 162

Commentary

198. Paragraph (1) is intended to reflect a generally accepted principle in private international law, according to which the mandatory law of the forum may be applied irrespective of the law otherwise applicable (see article 7 of the Rome Convention and article 11 of the Mexico City Convention). Mandatory law in this context does not refer to law that cannot be derogated from by agreement (as in article 28 (3)), but to law of fundamental importance, such as consumer protection law or criminal law (*loi de police*). Paragraph (2) introduces a different rule, namely, that a court in a Contracting State may apply neither its own law nor the law applicable under articles 28 and 29, but the law of a third country, on the ground that the matters settled in those provisions have a close connection with that country (it is derived from article 7 (1) of the Rome Convention, which is subject to a reservation, while more recent private international law texts include no such reservation). The scope of article 31 is limited to cases involving the law applicable to the contract of assignment and to the relationship between the assignee and the debtor. As to whether the law applicable to priority issues may be set aside as contrary to mandatory law rules of the forum State, it was generally thought that article 30 (3), under which a priority

rule of the law applicable may be set aside for the purpose of protecting, for example, a right of the forum State for taxes, was sufficient. Such a limitation of the mandatory-law exception was thought to be warranted, since priority rules are of a mandatory nature and setting them aside in favour of the mandatory rules of the forum or another State would inadvertently result in uncertainty as to the rights of third parties, a result that would have a negative impact on the availability and the cost of credit.

[Article 32. *Public policy*

With regard to matters settled in this chapter, the application of a provision of the law specified in this chapter may be refused by a court or other competent authority only if that provision is manifestly contrary to the public policy of the forum State.]

References:

A/CN.9/455, paras. 118 and 119
A/CN.9/466, paras. 163 and 164

Commentary

199. Article 32 differs from article 31 in that article 32 has only a negative effect, namely, that of setting aside a rule of the applicable law, if it is manifestly contrary to the international public policy of the forum (on this matter, see para. 180; see also article 16 of the Rome Convention and article 18 of the Mexico City Convention). In line with the approach followed in other international legal texts, the qualification "manifestly" has been added before the words "contrary to public policy". It should be noted that it is the application of the applicable law to a particular case and not the applicable law itself that needs to be manifestly contrary to the public policy of the forum. The application of a foreign law, therefore, cannot be refused on the ground that the law itself, in general, is considered to be inimical to the public policy of the forum, but only if the application of a particular rule in a concrete case would be repugnant to the public policy of the forum.

CHAPTER VI. FINAL PROVISIONS

Article 33. *Depositary*

The Secretary-General of the United Nations is the depositary of this Convention.

Reference:

A/CN.9/455, paras. 124 and 125

Commentary

200. The Treaty Section of the Office of Legal Affairs of the United Nations, located at United Nations Headquarters in New York, performs the depositary functions of the Secretary-General. Treaties deposited with the depositary are accessible through the home page of the Treaty Section on the World Wide Web (http:\\www.un.org\depositary).

Article 34. *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.

Reference:

A/CN.9/455, paras. 141 and 142

Commentary

201. The Commission may wish to consider the length of the time period during which the draft Convention should be open for signature by States. In conventions prepared by UNCITRAL, this period ranges from one year (in the case of the United Nations Convention on the Carriage of Goods by Sea, 1978 and the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade) to two and a half years (in the case of the United Nations Convention on International Bills of Exchange and International Promissory Notes).

Article 35. *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 any time, 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.

Reference:

A/CN.9/455, paras. 143 and 144

Commentary

202. Article 35 is intended to ensure that a federal State may adopt the draft Convention, even if, for any reason, it does not wish to have it apply to one or more territorial units. Such a right is particularly important for States with more than one legal system. The declaration may be made at any time, including before or after ratification, approval or accession (reference is made to a "State" and not to a "Contracting State", since a declaration may be made by a signatory State). The effect of a declaration under article 35 is that a party located in a territorial unit, to which the draft Convention is not to be applied by virtue of the declaration, is not considered to be located in a Contracting State (paragraph (3)). If that party is the assignor, the draft Convention would not apply at all. If that party is the debtor, the provisions of the draft Convention dealing with the rights and obligations of the debtor would not apply. The time when the debtor needs to be located in a Contracting State or when the law governing the assigned receivable needs to be the law of a Contracting State is not clear (article 1 (2)). Unless this time is specified in article 1 (2) (and possibly in article 35), if the debtor is located in a Contracting State at the time of the conclusion of the contract of assignment but, as a result of a declaration under article 35, not at the time a future receivable arises or at the time of notification, it would not be clear whether the draft Convention would apply in respect of such a debtor (for a secretariat suggestion in favour of the time of the conclusion of the original contract, see para. 17).

Article 36. *Conflicts with other international agreements*

This Convention does not prevail over any international agreement which has already been or may be entered into and which contains provisions concerning the matters governed by this Convention[, provided that the assignor is located in a State party to such agreement or, with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, the debtor is located in a State party to such agreement].

References:

A/CN.9/445, paras. 52-55, 75, 76 and 201-203
A/CN.9/455, paras. 67-73 and 126-129
A/CN.9/456, paras. 232-239
A/CN.9/466, paras. 192-195

Commentary

203. Reflecting generally acceptable principles as to conflicts among international legislative texts (see, e.g. article 30 of the Vienna Convention on the Law of Treaties, 1969 ("the Vienna Convention"); and article 90 of the United Nations Sales Convention), article 36 gives precedence to other texts that contain provisions that deal with matters covered by the draft Convention. Texts with which the draft Convention may be in conflict include the Ottawa Convention, the Rome Convention, the Mexico City Convention, the Guarantee and Standby Convention, the draft European Union Insolvency Regulation and the preliminary draft Convention on International Interests in Mobile Equipment.

Ottawa Convention

204. The substantive and territorial scope of the Ottawa Convention is narrower than the scope of the draft Convention (transactions not covered include factoring contracts, in which only one of the three services mentioned in article 1 of the Ottawa Convention is offered; no notification is given; the assignor, the assignee or the debtor is not located in a Contracting State). In addition, parties may exclude the application of the Ottawa Convention as a whole. Moreover, the Ottawa Convention does not address certain issues (e.g. priority issues). However, to the extent that the two Conventions apply to a factoring contract, their application may lead to conflicting results in a number of respects (e.g. the scope of the reservation to the rule on contractual limitations to assignment, notification relating to receivables not existing at the time of notification, discharge of the debtor by payment to the assignee with knowledge of another person's superior right and recovery from the assignee of payments made by the debtor). In such instances, the question would arise whether the draft Convention as a whole was set aside or whether it could apply, at least, with respect to matters not addressed in the Ottawa Convention (e.g. priority issues). The matter is not explicitly addressed in article 36, although the argument could be made that, with respect to such issues there would be no conflict and the draft Convention would apply, if the requirements for its application were met. The Commission may wish to address this matter explicitly in article 36. As to matters covered in the draft Convention and in the Ottawa Convention, to the extent any conflicts would arise, the Ottawa Convention would prevail. However, in view of the fact that the Ottawa Convention also contains a provision along the lines of article 36, it may not be clear which of the two Conventions would apply in a particular case. If the result is that the Ottawa Convention applies, a different problem arises. If the two conventions apply to a particular factoring contract, the Ottawa Convention prevails and the parties to the factoring contract or to the contract from which the assigned receivables arise, exclude the application of the Ottawa Convention (article 3 of the Ottawa Convention), the draft Convention would not apply by virtue of article 36 and the Ottawa Convention would not apply as its application would have been excluded by the parties. In such a case, again it would not be clear which law applied.

205. There are different ways in which these matters could be addressed. One way would be to leave the matter to party autonomy. If parties exclude the application of the Ottawa Convention and opt into the draft Convention, the draft Convention should apply, at least, if all the conditions for its application that are set forth in chapter I are met (although, in some States, the draft Convention may apply by virtue of their private international law rules even if it would not be applicable in the absence of a choice by the parties). Such a choice of law would normally be effective, unless it ran contrary to the public policy or mandatory law of the forum. This result, however, would run counter to the policy underlying articles 24 to 26 and 30 of the draft Convention, which do not allow parties to choose the law applicable to priority issues. Another way would be to

leave it to each State to decide which text it wishes to give precedence to (see, e.g. article 33 (2) in A/CN.9/WG.II/WP.104; see also article 20 of the Mexico City Convention; for critical remarks on this provision, see A/CN.9/466, paras. 192-195). Such an approach, however, could have a negative effect on certainty of law. Parties would need to examine each declaration and to determine its exact content, the connection with the location of the assignor or the debtor and the relevant time for the declaration to affect the interests of the assignor, the assignee and third-party creditors, on the one hand, and the interests of the debtor, on the other hand. Yet another way to address these matters would be to provide explicitly in article 36 that the draft Convention would apply to factoring contracts and issues not addressed in the Ottawa Convention. The possible disadvantage of such an approach is that, in order to determine whether the draft Convention would apply to a particular factoring contract, parties would have to examine the Ottawa Convention. This result might complicate the application of the draft Convention and raise the cost of the transaction. A fourth way to address conflicts with the Ottawa Convention would be for the draft Convention to supersede the Ottawa Convention. Such an approach would raise a question of legislative policy that States would need to address. From a substantive point of view, however, such an approach seems to provide the highest possible degree of certainty. Language along the following lines could be considered for insertion in article 36:

Variant A

"(2) If this Convention is set aside by virtue of paragraph (1) of this article and the application of the Ottawa Convention is excluded by the parties to the factoring contract or to the original contract, such parties may opt into this Convention [if the conditions of chapter I are met]."

Variant B

"(2) A State may declare at any time that the Convention will not prevail over international conventions or other multilateral or bilateral agreements listed in the declaration, which it has entered or will enter into and which contain provisions concerning the matters governed by this Convention."

Variant C

"(2) If the Ottawa Convention does not apply or with respect to an issue not addressed in the Ottawa Convention, this Convention applies."

Variant D

"(2) Notwithstanding paragraph (1) of this article, this Convention supersedes the Ottawa Convention."

206. Variant A would be consistent with the principle of party autonomy. Variants B to D would be in line with article 30 (2) of the Vienna Convention, which allows for a treaty to specify which treaty prevails in the case of conflicts. If the Commission decides to retain the bracketed language in article 36, it would need to be supplemented by a reference to the application of the draft Convention with respect to the rights and obligations of the debtor in cases where the law governing the receivable is the law of a Contracting State (article 1 (2)).

Mexico City and Rome Conventions

207. There are no conflicts between the draft Convention and the Mexico City Convention, which addresses the law applicable to contracts in general (not assignment in particular) and in a way that is consistent with article 28 of the draft Convention. Any conflicts between article 12 of the Rome Convention and articles 28 and 29 of the draft Convention are minimal, since those articles are identical with article 12 of the Rome Convention (with the exception of the express choice required in article 28 (1) and the rebuttable presumption foreseen in article 28 (2)). Furthermore, normally, no conflicts should arise between article 12 of the Rome Convention and article 30 of the draft Convention, since, according to the prevailing view, article 12 of the Rome Convention does not address this matter. However, in the literature and in case law, the view has been expressed that article 12 of the Rome Convention addresses issues of priority, either in paragraph (1) (the law chosen by the parties) or in paragraph (2) (the law governing the receivable). The Working Group has taken the position that neither of those two laws is appropriate. In any case, in order to avoid any conflict with the Rome Convention, article 37 provides that a State may opt out of chapter V. As a result, if all States parties to the Rome Convention opt out of chapter V, no conflict would arise. However, an opt-out of articles 24 to 26 is not allowed. Therefore, conflicts may arise between articles 24 to 26 of the draft Convention and article 12 of the Rome Convention. Neither article 36 nor its equivalent article 21 of the Rome Convention would sufficiently clarify which convention applies in the case of conflicts, since they both give way in favour of another text. As a result, uncertainty might prevail. The matter could be left to the principles of public international law, under which the more specific or the substantive law text (i.e. the draft Convention) would prevail. However, addressing the matter explicitly in article 36 would enhance certainty. The Commission may wish to consider leaving the matter to party autonomy or to each State, or allowing the draft Convention to supplement or supersede the Rome Convention (see the variants presented in para. 205).

208. The Commission may wish to consider whether article 36 should also address conflicts with supra-national law that is not in the form of an international agreement (e.g. EU regulations). Addressing the matter in article 36 and giving precedence to such supra-national law could remove a possible obstacle to some States adopting the draft Convention.

European Union draft Insolvency Regulation

209. No conflicts arise with the draft European Union Insolvency Regulation (approved by the Council of the Union and pending before the European Parliament). The notion of central administration is identical with the centre of main interests used in the draft Insolvency Regulation and that Regulation does not affect rights in rem in a main insolvency proceeding. While the draft Insolvency Regulation might affect rights in rem in a secondary insolvency proceeding (articles 2 *(g)*, 4 and 28), article 25 would be sufficient to preserve, for example, super-priority rights and, in any case, the draft Convention should not affect special insolvency rights (see paras. 179-182).

Guarantee and Standby Convention

210. If the assignment of the right to demand payment of an independent undertaking is excluded from the draft Convention and the assignment of proceeds of such an undertaking is subject to article 5, no conflicts arise with the Guarantee and Standby Convention (see paras. 48 and 52).

Preliminary draft Convention on International Interests in Mobile Equipment

211. Conflicts may arise with the preliminary draft Convention on International Interests in Mobile Equipment, currently being prepared by a group of experts in the context of the International Civil Aviation Organization (ICAO), Unidroit and other organizations. This preliminary draft Convention is intended to apply to high-value mobile equipment, although it contains no definite list of types of equipment to be covered and in article 2 it refers to a "uniquely identifiable object". It does, however, require the preparation of a protocol for the draft Convention to apply to a particular type of equipment (article 7). The main characteristic of this preliminary draft Convention with respect to an assignment of receivables is that it treats the principal obligation, that is, the receivable arising from the sale or lease of mobile equipment, as an accessory right of the security right in mobile equipment. As a result, an assignee who registers its security right in the mobile equipment with the international equipment-specific register of the preliminary draft Convention would automatically obtain the principal obligation. An assignee of the principal obligation without a security right in the mobile equipment could not register or obtain priority. Under article 36, any conflicts with the preliminary draft Convention would be resolved in favour of the application of the preliminary draft Convention (a matter that may be further clarified in the preliminary draft Convention). The same result would be reached, even in the absence of article 36, since according to general principles of customary treaty law the more specific text prevails (lex specialis derogat legi generali).

Article 37. *Application of chapter V*

A State may declare at any time that it will not be bound by chapter V.

References:

A/CN.9/455, paras. 72 and 148
A/CN.9/466, paras. 196 and 197

Commentary

212. In order to make the draft Convention more acceptable to States parties to existing private international law texts, such as the Rome Convention, article 37 allows States to opt out of chapter V. Such an opt-out is consistent with the decision of the Working Group that chapter V should form an integral part of the draft Convention. Unlike an opt-out, an opt-in could have the unintended effect of discouraging States from adopting chapter V.

Article 38. *Limitations relating to Governments and other public entities*

A State may declare at any time that it will not be bound by articles 11 and 12 if the debtor or any person granting a personal or property right securing payment of the assigned receivable is located in that State at the time of the conclusion of the original contract and is a Government, central or local, any subdivision thereof, or any public entity. If a State has made such a declaration, articles 11 and 12 do not affect the rights and obligations of that debtor or person.

References:

A/CN.9/432, para. 117
A/CN.9/455, para. 48
A/CN.9/456, paras. 115 and 116
A/CN.9/466, paras. 107-115

Commentary

213. Article 38 is intended to ensure that sovereign debtors are not affected by assignments made in violation of contractual limitations on assignment contained in public procurement or other similar contracts. As a result of article 38, an assignment of receivables owed by a sovereign debtor located in a State that has made a declaration at the time of the conclusion of the original contract is not effective as against the sovereign debtor. However, the assignment remains effective as against the assignor and the assignor's creditors. The Working Group decided to take this approach so as to avoid reducing the acceptability of the draft Convention to States that may not be able to protect sovereign debtors by way of a statutory limitation. The Working Group recognized that most States would protect sovereign debtors by way of a statutory limitation, which the draft Convention would not affect. It was also widely felt that a substantive rule giving full effect to a contractual limitation and invalidating the assignment as against a sovereign debtor, would raise the cost of credit for sovereign debtors irrespective of whether they wished or needed to be protected in such a way. Furthermore, the Working Group recognized that, once the sovereign debtor was protected, there was no reason to invalidate the assignment in general. Preserving the validity of the assignment as between the assignor and the assignee would allow the assignee to obtain priority by meeting the requirements of the law of the assignor's location.

214. Unlike article 6 of the Ottawa Convention, which allows a reservation with regard to any debtor, article 38 allows a reservation only with respect to sovereign debtors. In taking this approach, the Working Group was of the view that States considering the adoption of the draft Convention would need to weigh the potential inconvenience to the debtor of having to pay a different person against the advantage of increased availability of lower-cost credit to debtors and assignors, which could stimulate the economy at large. Article 38 is intended to allow a State to exclude the application of articles 11 and 12 in the case of any entity of the central or local Government or any subdivision thereof. As to public entities, article 38 leaves a wide

flexibility to States to determine the types of entities they wish to exclude from the application of articles 11 and 12 (without limiting the application of article 38 to publicly owned commercial entities or to governmental authorities acting in a commercial capacity). The Working Group recognized that it was the prerogative of each State to determine which type of public entity it wished to protect. Such an approach is particularly necessary in those countries in which government entities and their activities are not governed by a special body of public law but are subject to the rules governing "commercial" entities and activities.

[Article 39. *Other exclusions*

A State may declare at any time that it will not apply the Convention to specific practices listed in a declaration. In such a case, the Convention does not apply to such practices if the assignor is located in such a State or, with respect to the provisions of this Convention which deal with the rights and obligations of the debtor, the debtor is located in such a State.]

Reference:

A/CN.9/466, paras. 198-201

Commentary

215. With a view to making the draft Convention more acceptable to States that might be concerned with its application to certain practices, article 39 provides the possibility for States to exclude further practices. Article 39 appears within square brackets pending final determination of the exact scope of the draft Convention. Once the scope of the draft Convention and, in particular, article 5 is finalized, the Commission may wish to consider whether article 39 would be necessary. If article 39 is retained, reference would have to be included in the second sentence to the law governing the receivable and to the time of the original contract at which the debtor would need to be located in a Contracting State or the law governing the assigned receivable would need to be the law of a Contracting State (article 1 (2); see also para. 17). As a substitute for the second sentence of article 39, a new second paragraph could be considered along the following lines:

"(2) If a State makes a declaration under paragraph (1) of this article:

"*(a)* The Convention does not apply to such practices if the assignor is located at the time of the conclusion of the contract of assignment in such a State; and

"*(b)* The provisions of the Convention that affect the rights and obligations of the debtor do not apply if, at the time of the conclusion of the original contract, the debtor is located in such a State or the law governing the receivable is the law of such a State."

Article 40. *Application of the annex*

(1) A Contracting State may at any time declare that

Variant A

it will be bound either by sections I and/or II or by section III of the annex to this Convention.

Variant B

it:

(a) Will be bound by the priority rules based on registration set out in section I of the annex and will participate in the international registration system established pursuant to section II of the annex;

(b) Will be bound by the priority rules based on registration set out in section I of the annex and will effectuate such rules by use of a registration system that fulfils the purposes of such rules [as set forth in regulations promulgated pursuant to section II of the annex], in which case, for the purposes of section I of the annex, registration pursuant to such a system shall have the same effect as registration pursuant to section II of the annex; or

(c) Will be bound by the priority rules based on the time of the contract of assignment set out in section III of the annex.

(2) For the purposes of article 24, the law of a Contracting State that has made a declaration pursuant to paragraph (1) *(a)* or *(b)* of this article is the set of rules set forth in section I of the annex, and the law of a Contracting State that has made a declaration pursuant to paragraph (1) *(c)* of this article is the set of rules set forth in section III of the annex. The Contracting State may establish rules pursuant to which assignments made before the declaration takes effect shall, within a reasonable time, become subject to those rules.

(3) A Contracting State that has not made a declaration pursuant to paragraph (1) of this article may, pursuant to its domestic priority rules, utilize the registration system established pursuant to section II of the annex.

References:

A/CN.9/455, paras. 122 and 130-132
A/CN.9/466, paras. 188-191, 202 and 203

Commentary

216. Article 40 is intended to list the choices available to States with regard to the annex and the effects of any such choice made by way of a declaration (permitted under article 1 (4); see para. 23). It contains two alternatives. Variant A briefly presents the choices available to States, without addressing their effects (its content and formulation and, in particular, the words "and/or" have not been approved by the Working Group). Variant B is a more elaborate version of variant A and sets forth the various choices and their effects. Under variant B, States would have four alternative choices with regard to the annex, namely, to adopt the priority rules of section I and the registration system proposed in section II (paragraph (1) *(a)*); to adopt the priority rules of section I and a registration system other

than that proposed in section II (paragraph (1) *(b)*); to adopt the priority rules of section III (paragraph (1) *(c)*); or to adopt the registration system of section II and priority rules other than those set forth in section I (paragraph (3)). The difference between the choices in paragraph (1) and the choice in paragraph (3) is that, a State would not need to make a declaration to exercise the choice given in paragraph (3) of the second alternative. Under paragraph (2) of variant B, depending on which section of the annex a State has opted into, section I or section III of the annex is the law of the assignor's location, provided that the State that has made the declaration is the State of the assignor's location at the time of the conclusion of the contract of assignment (a matter that would need to be stated explicitly in article 40). In line with articles 35 to 39 and 41, article 40 should refer to a State (not a Contracting State), since a declaration may be made "at any time", including at the time of signature but before ratification, acceptance or approval.

Article 41. *Effect of declaration*

(1) Declarations made under articles 35 (1) and 37 to 40 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 35 (1) and 37 to 40 may withdraw it at any time by a formal notification in writing addressed to the depositary. Such withdrawal takes effect on the first day of the month following the expiration of six months after the date of the receipt of the notification by the depositary.

[(5) A declaration or its withdrawal does not affect the rights of parties arising from assignments made before the date on which the declaration or its withdrawal takes effect.]

References:

A/CN.9/445, paras. 79 and 80
A/CN.9/455, paras. 145 and 146
A/CN.9/466, para. 206

Commentary

217. Paragraphs (1) to (4) reflect standard treaty law practice. Under paragraphs (1) and (2), declarations made at the time of signature must be confirmed at the time of ratification, approval or accession; and declarations and confirmations must be in writing and formally notified to the depositary. Under paragraph (3), a declaration takes effect at the same time the Convention enters into force in respect of the State making the declaration. There is a six-month delay if the depositary is notified of the declaration after the entry into force. The six-month period starts at the time of receipt of the formal notification by the depositary and ends on the first day after the expiry of the six-month period. Under paragraph (4), withdrawals of declarations take effect on the first day after the expiry of six months after the receipt of the formal notification by the depositary.

218. Paragraph (5) deals with an issue relating to the transitional application of the draft Convention. Like the transitional application rules in articles 43 (3) and 44 (3), it appears within square brackets, since the Working Group decided to leave this matter to the Commission (see A/CN.9/466, para. 206). Issues relating to the transitional application of the draft Convention are made more complex by the fact that an assignment may affect the interests of more than the parties thereto and different points of time may need to be taken into account for the protection of the various parties. Paragraph (5) is intended to ensure that, if a State makes or withdraws a declaration under articles 35, 37, 38, 39 or 40, the declaration or withdrawal does not affect rights acquired before the declaration or its withdrawal takes effect.

219. Paragraph (5) would need to refer also to obligations and to specify the effect on all parties, assignors, assignees and debtors. Like article 39, paragraph (5) would also need to clarify whose rights and obligations are affected, depending on whose State makes or withdraws a declaration and when. A declaration or its withdrawal made by the State in which the assignor is located at the time of the conclusion of the contract of assignment should not be allowed to affect the rights and obligations of the debtor. A declaration made by the State in which the debtor is located or whose law governs the receivable (at the time of the conclusion of the original contract; see articles 1 (2) and 35, as well as paras. 17 and 202) should not affect the priority among competing claimants. Only a declaration or its withdrawal made by the State or States in which the assignor and the debtor are located could affect the rights and obligations of all parties (this is practically possible only if the assignor and the debtor are located in the same State or at the initial entry into force of the draft Convention when it enters into force at the same time for all five Contracting States (articles 41 (3) and 43 (1)). Paragraph (5) may also need to deal with the issue of assignments of receivables arising after a declaration or its withdrawal takes effect but before the debtor receives notification of the assignment. It would appear that, in such a case, the declaration or its withdrawal could be allowed to affect the debtor's rights and obligations. Such a result would not frustrate any legitimate expectations of the debtor relating to the application of the draft Convention, since before notification is received the debtor does not know whether the draft Convention would apply and, therefore, cannot have expectations as to the exact effect of the draft Convention on its rights and obligations.

Article 42. *Reservations*

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

Reference:

A/CN.9/455, paras. 147 and 148

Commentary

220. Article 42, which reflects standard treaty law practice, is intended to ensure that no reservation is made other than those expressly authorized in articles 35 (1) and 37 to 40.

Article 43. *Entry into force*

(1) This Convention enters into force on the first day of the month following the expiration of six months 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 six months 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 article 1 (1).]

References:

A/CN.9/455, paras. 149 and 150
A/CN.9/466, para. 206

Commentary

221. Paragraphs (1) and (2) reflect standard treaty law practice. In determining that six months and five ratifications are required for the draft Convention to enter into force, the Working Group took into account the need for the draft Convention to enter into force as soon as possible, provided that it has received support from a sufficient number of States. Paragraph (3) is intended to ensure that rights acquired before the entry into force are not affected by the draft Convention. Like articles 41 (5) and 44 (3), it appears within square brackets, since the Working Group decided to leave to the Commission issues relating to the transitional application of the draft Convention (see A/CN.9/466, para. 206).

Article 44. *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.

[(3) The Convention remains applicable to assignments made before the date on which the denunciation takes effect.]

References:

A/CN.9/455, paras. 151-155
A/CN.9/466, para. 206

Commentary

222. Article 44 is intended to ensure that a Contracting State may denounce the draft Convention. The second sentence of paragraph (2) may not be necessary. If a State wishes to prolong the time for the denunciation to take effect, it may postpone notifying the depositary. Allowing States to vary the time at which denunciations take effect may result in uncertainty as to the application of the draft Convention or, at least, to raising the cost of transactions, to the extent that parties would need to check declarations made by States so as to determine the time when the denunciation takes effect. Furthermore, such an approach would be inconsistent with article 41 (3), which does not allow States to vary the time at which a declaration takes effect. With a view to ensuring certainty, paragraph (3) provides that a denunciation does not affect rights acquired before it takes effect. Such an approach is particularly necessary to protect rights of third parties, who might have extended credit against future receivables, while relying on the application of the draft Convention. Without such a uniform rule, third parties would need to rely on substantive rules on supervening changes of law provided under various legal systems, which might provide conflicting or unsatisfactory solutions for the situations under consideration. Such a result would be inconsistent with the main objective of the draft Convention to facilitate access to lower-cost credit.

Additional final provisions

223. The Commission may wish to consider including in the final provisions the following provision, which the Working Group, at its thirty-first session, did not have sufficient time to discuss (see A/CN.9/466, paras. 207 and 208):

"Article X. *Revision and amendment*

"1. At the request of not less than one third of the Contracting States to this Convention, the depositary shall convene a conference of the Contracting States for revising or amending it.

"2. Any instrument of ratification, acceptance, approval or accession deposited after the entry into force of an amendment to this Convention is deemed to apply to the Convention as amended."

ANNEX TO THE DRAFT CONVENTION

References:

A/CN.9/420, paras. 155-164
A/CN.9/434, paras. 239-258
A/CN.9/445, paras. 18-44 and 83-93
A/CN.9/455, paras. 18-32 and 120-123

Commentary

224. In view of the fact that the Working Group was not able to reach agreement on a substantive law priority rule, articles 24 to 26 refer priority issues to national law (the law of the assignor's location). However, national priority

rules may not exist, be outdated or not fully adequate in addressing all relevant problems. For that reason, the Working Group decided to include in an optional annex to the draft Convention two alternative substantive law priority rules, one based on the time of assignment and another based on registration. In order to determine whether their priority rules need revision, States may wish to compare them with the rules set forth in the annex.

225. While the rules set forth in the annex are intended to serve as a model for national legislation, they do not form a complete model law (and their application is limited to receivables). States would, therefore, need to prepare additional provisions. For example, if a registration-based system is chosen, some practices may need to be excluded from a registration-based priority regime and subjected to a different priority regime; and the registration rules would need to be supplemented by appropriate regulations. In general, the annex may apply only in a State that has made a declaration under article 40 (article 1 (4); see para. 23). The choices available to States and their effects are set forth in article 40 (see para. 216).

Section I. Priority rules based on registration

Article 1. *Priority among several assignees*

As between assignees of the same receivable from the same assignor, priority is determined by the order in which data about the assignment are registered under section II of this annex, regardless of the time of transfer of the receivable. If no such data are registered, priority is determined on the basis of the time of the assignment.

References:

A/CN.9/445, paras. 88-90
A/CN.9/466, paras. 167 and 168

Commentary

226. The registration system envisaged in article 1 involves the voluntary entering of certain data about an assignment in the public record. The purpose of such registration is not to create or constitute evidence of property rights, but to protect third parties by putting them on notice about assignments made and to provide a basis for settling conflicts of priority between competing, equally effective claims. Because of its limited function and for it to be simple, quick and inexpensive, the registration envisaged in article 1 requires a very limited amount of data (specified in article 4 of the annex) to be placed on public record. If no data are filed, the first-in-time assignee prevails.

227. The policy underlying article 1 (and sections I and II) is that giving potential financiers notice about assignments and determining priority in receivables on the basis of a public filing system will enhance certainty as to the rights of financiers and, as a result, have a beneficial impact on the availability and the cost of credit on the basis of receivables. In order to ensure that the priority rules in section I operate with an existing national registration system, article 1 (which refers to a system under section II that would need to be established under article 3 of the annex) may need to be revised.

Article 2. *Priority between the assignee and the insolvency administrator or the creditors of the assignor*

[Subject to article 25 of this Convention,] an assignee has priority over an insolvency administrator and creditors of the assignor, including creditors attaching the assigned receivables, if the receivables were assigned, and data about the assignment were registered under section II of this annex, before the commencement of the insolvency proceeding or attachment.

Reference:

A/CN.9/466, paras. 169 and 170

Commentary

228. Article 2 is intended to reflect the principle that, if registration takes place before the commencement of an insolvency proceeding with regard to the assets and affairs of the assignor or before attachment of the receivables in the hands of the assignor, the assignee has priority. As a result, the assignee may receive payment before unsecured creditors (special preferential rights existing under insolvency law, however, are not affected, see para. 182) . Furthermore, with a view to preserving any super-priority rights (e.g. claims of the State for taxes, of employees for wages or of the insolvency administrator for the costs of insolvency), the application of article 2 is made subject to article 25.

Section II. Registration

Article 3. *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 in detail the manner in which the registration system will operate, as well as the procedure for resolving disputes relating to that operation.

References:

A/CN.9/445, paras. 94-103
A/CN.9/466, paras. 171 and 172

Commentary

229. The policy underlying article 3 is that, while the annex should include some basic provisions about registration, the mechanics of the registration process should be left to regulations to be prepared by the registrar and the supervising authority. In order to avoid creating the impression that the regulations might need to be more detailed than is practically necessary and to give sufficient flexibility to the registrar and the supervising authority in preparing the regulations, article 3 refers to the regulations prescribing “in detail” (but not “exactly”) the operation of the registration system.

230. The registrar (who may, presumably, be a private entity) and the supervising authority (which is intended to be an intergovernmental organization) would have significant powers in settling, in addition to the mechanics of registration, substantial issues, such as court jurisdiction over, duties, liability, privileges and immunities of, the registrar. The Commission may, therefore, wish to consider ways in which the appointment of a supervising authority and a registrar should be effected. As the registrar and the supervising authority would be given wide powers with regard to the implementation of the draft Convention, it would seem that a process similar to the revision process involving a conference of Contracting States would be appropriate (see A/CN.9/466, paras. 165 and 166). Alternatively, the Commission may wish to identify in the annex an international, intergovernmental organization as the supervising authority and, possibly, the first registrar; and to deal in the annex with certain key issues, such as court jurisdiction over, duties and liability, as well as privileges and immunities of, the registrar and costs for establishing and operating the system (this is the approach followed in the ICAO/Unidroit preliminary draft Convention on International Interests in Mobile Equipment and in the preliminary draft Aircraft Protocol; see articles XVI and XIX of the preliminary draft Aircraft Protocol and articles 26, 26*bis* and 40 of the preliminary draft Convention).

Article 4. *Registration*

(1) Any person authorized by the regulations may register data with regard to an assignment at the registry in accordance with this Convention and the registration regulations. The data registered shall be identification of the assignor and the assignee, as provided in the regulations, 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. The registering party may specify, from options provided in the regulations, a period of effectiveness for the registration. 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 and, consistent with this annex, such other matters as are necessary for the operation of the registration system.

(4) Any defect, irregularity, omission or error with regard to the identification of the assignor that would result in data registered not being found upon a search based on the identification of the assignor renders the registration ineffective.

References:

A/CN.9/445, paras. 104-117
A/CN.9/466, paras. 173-178

Commentary

231. The purpose of article 4 is to establish the basic parameters for an efficient registration system. Those basic parameters include the public character of the registry, the type of data that need to be registered, the ways in which the registration-related needs of modern financing practices may be accommodated and the time of effectiveness of registration. The registry envisaged is a public registry. However, in order to avoid any abuses, some limitations may have to be introduced as to the persons who may register (e.g. only persons with a legitimate interest or with the authorization of the assignor) and the assignor may need to be given the right to demand deregistration. Paragraph (1) leaves those issues to the regulations. The regulations could also deal with abusive and fraudulent registration, although this matter should normally not pose a problem, since registration under article 4 does not create any substantive rights. In any case, the issue of any loss caused as a result of an unauthorized or fraudulent registration could be addressed by general tort, fraud or even criminal law rules. The data to be registered, under paragraph (1), include identification of the assignor and the assignee and a brief description of the assigned receivables. The type of identification required is left to the regulations. It is meant to include, however, identification by number. The words “brief description” are intended to include a generic description, such as “all my receivables from my car business” or “all my receivables from countries A, B and C”. Paragraph (2) is a key provision in that it is intended to ensure the efficient operation of the registration system and to accommodate the needs of significant transactions. Under subparagraphs *(a)* and *(c)*, a single notice could cover a large number of receivables, existing or future, arising from one or several contracts, as well as a changing body of receivables and a constantly changing amount of secured credit (revolving credit). Without these features, registration would be expensive, slow and inefficient. Any abuse, which could harm the assignor without, however, creating substantive rights, is left to other legislation.

232. Under paragraph (3), registration is effective when searchers obtain access to the data registered. This means that, if the assignor becomes insolvent after registration but before the data become available to searchers, the risk of any events that may affect the interests of the registering party is placed on that party. With the exception of cases involving the restructuring of troubled credits, in which prompt disbursement of funds is essential, the registering party may protect itself by withholding disbursements until registered data become available. Such a risk would be significantly reduced if there was no time gap between data being registered and becoming available to searchers, which is possible in the case of electronic registration systems. Paragraph (3) permits registering parties to choose the length of time of effectiveness from a range of options set out in the regulations. In the absence of a choice, the time of effectiveness is five years. Renewals, discharges and amendments, as well as any other matters necessary for the operation of the registry, are left to the regulations. With a view to preserving registrations with minor errors, paragraph (4) invalidates a registration only if there is a defect, irregularity or omission in the identification of the assignor that would preclude searchers from finding the data registered. The underlying rationale is that: if the error

is made by the registering party, that party should suffer the consequences; and if the error is committed by the registrar, the registrar should be held liable (an issue to be addressed in the regulations). The words "would result" are intended to ensure that the registration would be ineffective, in the case of a significant error in the identification of the assignor, even if no one was actually misled. Minor errors or omissions in the identification of the assignor, or any errors or omissions in the identification of the assignee or the description of the assigned receivables, do not render the registration ineffective.

Article 5. *Registry searches*

(1) Any person may search the records of the registry according to identification of the assignor, as provided in the regulations, 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.

References:

A/CN.9/445, paras. 118 and 119
A/CN.9/466, paras. 179 and 180

Commentary

233. Article 5 is intended to enshrine the principle of public access to the registry for searching purposes as opposed to registration purposes. Only a publicly accessible registry could provide the transparency necessary to enhance certainty with regard to the rights of third parties. Such public access to the registry does not infringe upon the confidentiality necessary in financing transactions, since only a limited amount of data would be available in the registry. Article 5 also provides for the admissibility and the general evidential value of a search record in a court or other tribunal. A search record is, in particular, evidence of the data necessary to establish priority, that is, the date and the time of registration and the order of registration.

Section III. Priority rules based on the time of the contract of assignment

Article 6. *Priority among several assignees*

As between assignees of the same receivable from the same assignor, the right to the receivable is acquired by the assignee whose contract of assignment is of the earliest date.

References:

A/CN.9/445, paras. 83-87
A/CN.9/466, paras. 181-185

Commentary

234. Under article 6, the first-in-time assignee acquires the assigned receivable. Any subsequent assignee obtains nothing, since the assignor has nothing more to transfer (nemo dat quod non habet). If there cannot be more than one effective assignment of the same receivables by the same assignor, no conflict of priority can arise as between several assignees of those receivables. In addition, article 6 may not address a priority conflict as between several assignees, if the assignor assigns different parts of the same receivables to different assignees, since, assuming that national legislation allows the assignment of parts of receivables, different "receivables" would be involved. Moreover, article 6 would not address a conflict of priority between several assignees, if the same receivables are assigned by the assignor to different assignees to secure different amounts of credit not exceeding the value of the receivable. If that is the intended meaning of article 6, the title of section III and article 6, which refer to "priority", would need to be revised. If, under article 6, more than one assignment of the same receivables may be effective, article 6 would need to be revised, for example, along the following lines: "As between assignees of the same receivable from the same assignor, priority is determined on the basis of the time of assignment". In its deliberations, the Commission may wish to consider the priority system introduced by draft articles 12.401 of the European Contract Principles. Under that article, priority is to be determined on the basis of time of notification of the debtor and, in the absence of a notification, on the basis of the time of assignment. In either case, the requirements of the law applicable to insolvency have to be met.

Article 7. *Priority between the assignee and the insolvency administrator or the creditors of the assignor*

[Subject to article 25 of this Convention,] an assignee has priority over an insolvency administrator and creditors of the assignor, including creditors attaching the assigned receivables, if the receivables were assigned before the commencement of the insolvency proceeding or attachment.

References:

A/CN.9/445, paras. 83-87
A/CN.9/466, paras. 186 and 187

Commentary

235. Unlike article 6 of the annex, article 7 refers to priority. However, if the receivable is effectively transferred before commencement of an insolvency proceeding or attachment, at least in the case of an outright assignment, no issue of priority arises (the receivable is not part of the insolvency estate). Such a priority issue may arise in the case of an assignment by way of security, where the assignee would seek to be paid first out of the proceeds of the receivable. Depending on the correct understanding of article 7, the Commission may wish to revise it. As in article 2 of the annex priority is not intended to affect special insolvency rights (see para. 182); and the opening words are intended to preserve super-priority rights under the law of the forum State (see para. 181).

A/CN.9/472

F. Draft Convention on Assignment [in Receivables Financing] [of Receivables in International Trade]: compilation of comments by Governments (A/CN.9/472 and Add.1-4) [Original: English]

CONTENTS

INTRODUCTION

1. At its thirty-first session, held in Vienna from 11 to 22 October 1999, the Working Group on International Contract Practices adopted the draft Convention on Assignment [in Receivables Financing] [of Receivables in International Trade] and requested the secretariat to transmit the draft Convention to all States and interested international organizations for comments. With a view to assisting delegates in finalizing the draft Convention at the thirty-third session of the Commission, to be held in New York from 12 June to 7 July 2000, the Working Group also requested the secretariat to prepare an analytical compilation of those comments (A/CN.9/466, para. 215)

2. This note sets forth, with minimal editorial modifications, the first comments received from Governments. Any further comments will, upon receipt by the secretariat, be included in an addendum to this note.

COMPILATION OF COMMENTS

Czech Republic

[Original: English]

I. General comments

We highly appreciate all activities and work done by the UNCITRAL with a view to increasing the availability of lower-cost credit in assignments of receivables in international trade. In our country, legal regulation of assignments of receivables is very general. Nevertheless, it differs in some aspects from the draft Convention.

Our most serious concern relates to articles 11 and 12 of the draft Convention. Under Czech law, it is not possible to assign a receivable contrary to an agreement between the assignor and the debtor. Any assignment effected by violation of such an agreement is null and void. The same problem arises in relation to article 5, variant A.

In addition, we are concerned about articles 15 and 17, which leave the notification of the debtor to the discretion of the assignor or the assignee. Under Czech law, the assignor is obliged to notify the debtor without undue delay. Another concern relates to article 21, which permits waivers of future defences and rights of set-off. Under our national law, such a waiver is null and void.

II. Specific comments

Title and preamble

We have no particular preference with regard to the title and the preamble. We do not object to the deletion of article 6 *(c)*, as long as the preamble contains an indicative list of practices to be covered by the draft Convention.

Scope of chapter V (article 1 (3))

We agree with the retention of article 1 (3).

Exclusion or special treatment of certain practices (article 5)

We support the exclusion of practices relating to the assignment of financial receivables from the scope of articles 11 and 12, as proposed in A/CN.9/466, paragraph 71. In article 5, for the reasons mentioned above, we would prefer variant B.

"Location" (article 6 (i)*)*

We agree with the definition reflected in A/CN.9/466, paragraph 96. The proposal in A/CN.9/466, paragraph 99, as to branch offices of financial service providers is also acceptable to us.

Application of the annex (article 40)

As to article 40, we prefer the second set of bracketed language.

Effects of declarations on third parties (article 41 (5))

We agree with the proposed wording in square brackets.

III. Conclusion

In conclusion, we have to state that, due to the divergences between our national legal system and the draft Convention mentioned above, at this stage, the Czech Republic will not be able to adopt the draft Convention, since this would require a change in our Civil or Commercial Code. At this stage, the harmonization of our law with the law of the European Union is a matter of higher priority for our country.

While we recognize the practical significance of practices to be covered by the draft Convention, we would note that they are rather new in the Czech Republic (developed in the last eight years) and they relate to a small part of the market (although, one of the reasons for this situation is the lack of sufficient legislation). For this reason, we are very interested in the draft Convention and we hope to have the opportunity to adopt it in the future.

Denmark

[Original: English]

I. General comments

Generally, Denmark appreciates and welcomes the preparation of the UNCITRAL draft Convention on Assignment [in Receivables Financing] [of Receivables in International Trade] ("the draft Convention"). Furthermore, Denmark finds that, if adopted in a sufficient number of States, the draft Convention could lead to an improvement of the possibilities of obtaining credit by assignments of receivables.

II. Specific comments

Denmark wishes to make the following comments with respect to articles 1 (3), 6 *(i)*, 24, 25 (2), 26 and 36.

Scope of chapter V (article 1 (3))

In order to indicate the importance of regulation of the international private law, in particular on priority questions, chapter V should be retained as a part of the draft Convention with an opt-out possibility (see A/CN.9/WG.II/WP.104, pages 37-38; and A/CN.9/466, para. 148).

"Location" (article 6 (i)*)*

In order to establish certainty and transparency, the place of business, to which the contract has its closest connection, should be considered as the connecting factor in the definition of the term "location" in article 6 *(i)* (see A/CN.9/466, para. 96, variant A, and paras. 25-30). Such a place of business is visible to third parties, while the place of "central administration" or the "centre of main interests" is not always obvious and predictable for third parties, who need to know which law will apply to a future assignment. Furthermore, regardless of which connecting factor is chosen, the connecting factor should be clearly explained in the commentary on the draft Convention, so as to facilitate its understanding.

Change of location of the assignor and law applicable to priority (article 24)

While a change in the location of the assignor will probably not take place often, we would suggest that the Commission considers whether a provision dealing with a change in that location is needed (e.g. similar to the regulation in article 9 of the U.S. Uniform Commercial Code).

Super-priority rights (article 25 (2))

Article 25 (2) of the draft Convention deals with claims which according to local insolvency law are entitled to super-priority (i.e. priority over an assignee). Article 24 leaves priority to the law of the assignor, thus ensuring that an assignee can rely solely on the law of the assignor's location and calculate its risk, including the risk of any super-priority claims.

However, as an exemption to article 24, article 25 (2) preserves super-priority claims under an insolvency law other than the law of the assignor's location (in practice,

the law of the debtor). As a result, in order to evaluate the risk of any super-priority claims, the assignee has to examine both the law of the assignor's and the debtor's location. This result may lead to higher transaction costs.

It would not be appropriate to delete article 25 (2), since such an approach may bring the draft Convention in conflict with the European Union draft Insolvency Regulation (articles 2 *(g)*, 4 and 28). However, the Commission may wish to consider limiting the scope of article 25 (2) to cases where the insolvency proceedings with respect to the assignor are opened in a State in which the assignor has an establishment. Such an approach might reduce the assignee's risk without conflicting with the draft Insolvency Regulation and should be sufficient in protecting the interests of local creditors.

Furthermore, regardless of whether the scope of article 25 (2) is limited as suggested, the Commission may wish to consider making the declaration of any super-priority rights, which can be invoked in a secondary insolvency proceeding, mandatory. Such an approach would, at least, make a discovery of non-assignor law easier for the assignee. If States agree that lower transaction costs would improve access to credit, a duty to declare super-priority rights should not render the draft Convention unacceptable.

Meaning of proceeds (article 26)

In order to limit possible conflicts with national law on secured credit in assets other than receivables and to avoid addressing the complexities of re-perfection of security interests in proceeds, the Commission may wish to consider limiting the scope of article 26 to cash proceeds (e.g. money, cheques, deposit accounts). This result could be obtained by defining proceeds in article 6 *(k)* as cash proceeds only. In such a case, the last sentence of article 6 *(k)*, referring to returned goods, would be unnecessary and could be deleted.

Conflicts with other international texts (article 36)

According to article 36, the draft Convention does not prevail over other international agreements dealing with matters governed by the draft Convention. If the goal is to obtain a uniform approach, which would ensure the largest degree of predictability, the approach followed in article 36 may not be appropriate. For example, it would be uncertain to what degree article 12 of the Rome Convention deals with the matters governed by the draft Convention, and, if it does, which text would prevail (the Rome Convention contains a similar provision). In a comment to the draft Convention, it is stated that the conflicts between the Rome Convention and the draft Convention are minimal and that the prevailing view is that the Rome Convention does not deal with priority aspects (A/CN.9/466, para. 193). However, it should be noted that there exists national case law in Europe which seems to assume that the Rome Convention in fact deals with the law applicable to priority issues. While it may be argued that the draft Convention prevails since it is a substantive law text (A/CN.9/466, para. 194), this argument may not be fully correct, since, with regard to priority issues, the draft Convention (chapter IV, sec. III and chapter V, article 30) is in fact, to a large extent, a private international law text.

Consequently, in order to minimize the legal uncertainties arising from conflicting international agreements, it may be more appropriate if the draft Convention were to prevail over other texts, with the exception of texts listed in a declaration (A/CN.9/466, para. 192) and, perhaps, texts dealing with rights in receivables arising from the sale and lease of aircraft (A/CN.9/466, para. 83). Alternatively, the Commission could consider providing that the draft Convention would not prevail over other texts, with the exception of texts listed in a declaration. If article 36 is not revised, the commentary to the draft Convention should include explicit comments about conflicts with existing international agreements.

France

[Original: French]

Title of the draft Convention

France proposes the formulation "Convention on Assignment of Receivables in International Trade", which it feels is more in harmony with the vast scope of the text.

Non-contractual receivables (article 2 (a)*)*

Article 2 *(a)* refers to the "assignor's contractual right to payment of a monetary sum", a formulation which has the effect of excluding non-contractual receivables from the scope of application of the draft Convention. France would like to see non-contractual receivables covered by the draft Convention, at the very least, through the introduction of an optional system.

Limitations on receivables other than trade receivables (article 5)

The draft Convention intends to allow assignment of receivables even in circumstances where the agreement concluded between the assignor and the debtor contains an anti-assignment clause (article 11). A provision of this kind is incompatible with the global set-off mechanisms, which are applicable to reciprocal debts and receivables and on which all framework agreements that regulate operations on financial markets are based.[1]

[1]This applies, for example, to the "Global Master Repurchase Agreement" of the Public Securities Association and the International Securities Market Association, the "Master Agreement" of the International Swaps and Derivatives Association, the "European Master Agreement" of the Banking Federation of the European Union, the "Framework Convention of the French Bankers Association relating to Repurchase Transactions", the "Framework Convention of the French Bankers Association relating to Forward Transactions", and the Framework Agreements of the German Bankers Association on Repurchase Transactions and on Forward Transactions.

The Working Group on International Contract Practices put aside the idea of excluding financial receivables, defined as receivables other than trade receivables, from the scope of application of the draft Convention on the grounds that such an exclusion would have unduly curtailed the scope of the draft Convention. In fact, however, such a broad exclusion is not necessary, since the only receivables that might give rise to problems are those covered by a set-off mechanism and not all financial receivables in general.

Therefore, since it seems that financial receivables are to remain within the scope of the draft Convention, we must, at least, find a solution to ensure that the anti-assignment clauses necessary for the proper operation of framework set-off agreements retain their effectiveness. As it happens, the use of such framework agreemenst is encouraged by central banks and bank supervisory authorities because of their positive impact on the management of bank risks.

In A/CN.9/466, two solutions are proposed for article 5, "Limitations on receivables other than trade receivables", one proposed by the delegation of the United States of America (variant A) and the other proposed by the delegation of Canada (variant B). Variant A would validate an assignment as between the assignor and the assignee, but not as against the debtor, unless the debtor consented to the assignment. Variant B would leave the validity of an assignment, made in violation of an anti-assignment clause, to other law (which could treat such an assignment as invalid).

In principle, variant B is simpler than variant A, because it avoids the complications that would result from making a distinction between effect as between the parties and effect with regard to third parties, a distinction on which variant A is based. Furthermore, both variants are intended to apply to assignments of "receivables other than trade receivables" and reference is made to the definition of trade receivables in article 6 *(l)*.

Article 6 *(l)* (which is still bracketed in the Working Group's report) defines the term "trade receivable" as "a receivable arising under an original contract for the sale or lease of goods or the provision of services other than financial services". Yet, as we have explained above, not all receivables arising from financial-service contracts justify an exclusion from the scope of the draft Convention, but only those that are governed by a set-off agreement.

Accordingly, whether we retain variant B or variant A, it would be wise to formulate the definition of "trade receivable" in such a way that the scope of the exception introduced in article 5 would be limited to what is really necessary. One might, for example, suggest the following formulation in article 6 *(l)*:

> "'trade receivable' means a receivable arising under an original contract for the sale or lease of goods or the provision of services other than financial services when these latter are provided within the framework of an agreement that provides for set-off of all reciprocal debts and receivables of the parties".

Examples of such financial services (pensions, swaps, payment services, etc.) could usefully be given in the commentary, which the UNCITRAL secretariat will be preparing on the draft Convention.

Definition of location (article 6 (i)*)*

The French Government is in favour of the definition of location in article 6 *(i)*. However, it wishes to observe that this is problematic if the mechanism for assignment of receivables laid down in the draft Convention is to be used for refinancing branches of banks. The objective is, after all, to define the assignor's location, if it has more than one establishment, as the State in which its central administration is located. In particular, the location of the assignor would determine the priority rules to which the assignee's rights would be subject.

In practice, the definition in article 6 *(i)* would mean, in connection with an assignment of receivables between, for example, the Bank of France (as assignee) and a Paris branch of a foreign bank (as assignor), that the location of the assignor would be the State of its central administration, that is, the State where the headquarters of the foreign bank is located. The assignment of receivables would thus be subject to the law of that State, notably with regard to the applicable priority rules. Such a result would be completely unacceptable for the refinancing bank, whether it were a central bank or some other credit institution.

If we want to avoid seriously hampering the application of the draft Convention for purposes of inter-bank refinancing, a special regime must be found for branches of banks. A system of this kind would be all the more justified as bank branches are subject to the same obligations, notably with regard to consent, as banks which are legal entities under local law, subject, of course, to the special arrangements resulting from the "European passport". Even if the prudential supervision of banks remains within the competence of the authorities in the country where the bank's headquarters are located, responsibility for the provision of liquidity (i.e. refinancing) still belongs, even within the European framework, with the authorities of the host country (see article 14-2 of EEC directive No. 89/646, known as the second directive on coordination of bank legislation).

The special regime, of which we have been speaking, might consist of placing bank branches in the same category as the debtor, for which the relevant place of business is that "which has the closest relationship to the original contract" (subparagraph (iii)).

Application of the annex to conflicts of priority among competing assignees (articles 1 (4), 24 and 40)

It will be very difficult to make an instrument operate well, if several parallel priority rules may be applicable to a conflict of priority between several assignees who obtain the receivables from the same assignor. For example, if an assignment has priority under the law of State A, which has opted for sections I and II of the annex (registration), and another assignment has priority under the law of State B, in which the assignor is located and which has opted for the priority rules in section III of the annex (time of the contract of assignment), it is not clear whether the conflict before a court in State A will be resolved in conformity with sections I and II, or with section III of the annex.

It seems obvious that a court in a State, in which the assignor is located and which is a Contracting State, should apply the criteria of article 1 (1) *(a)* in determining whether the draft Convention, including article 24, applies. How-

ever, the text of the draft Convention is not sufficiently clear about this matter. Article 40, concerning the application of the annex, confines itself to indicating that "A Contracting State may ... declare that [it will be bound either by sections I and/or II or by section III of the annex to this Convention]". Paragraph (2) of article 40 stipulates that, for the purposes of article 24 (which governs the law applicable to competing rights of other parties), the law of a Contracting State that has made a declaration is the set of rules set forth in either section I of the annex or in section III. Article 1 (4) provides that the annex applies in a Contracting State which has made a declaration under article 40. It is, therefore, proposed that article 1 (4) should be amended as follows: "The annex to this Convention applies to the assignments referred to in a declaration made under article 40 by the Contracting State in which the assignor is located."

Consumer protection (articles 17 to 23)

With the exception of articles 21 and 23, the provisions in section II of chapter IV of the draft Convention do not go far enough in protecting the rights of consumer debtors. The Working Group decided that assignments to consumers are not excluded from the scope of the draft Convention, unless they are made for consumer purposes. It is, therefore, essential that the legal position of a consumer, whose debt to a bank results from a loan, secured by either movable or immovable property, or from an overdraft facility or from the use of a credit card, should not be affected by the instrument we are preparing. In this connection, the arguments developed in A/CN.9/WG.II/WP.106, para. 58, are valid not only for articles 21 and 23 but for all the articles in this section, since in France, as in many other countries, national law protects consumers in all those situations envisaged by the draft Convention, and most of these provisions of national law are mandatory law provisions.

Generally speaking, consumers, as debtors protected by law, cannot accept renunciation by contract of provisions reflecting public policy (e.g. French law No. 78-23 of 10 January 1978 on consumer credit). Moreover, the consumer is protected against unfair clauses, which the professional might be tempted to propose to him, by Community Directive (No. 93/13 of 5 April 1993) and by French law (article L 132-l of the Consumer Code, together with an annex comprising clauses considered to be unfair; and recommendations of the Commission on Unfair Clauses, notably the recommendation concerning clauses of implicit consent and the summing-up recommendation). Moreover, article 19, which provides that, when the debtor receives notification of the assignment, it only has to make payment to the assignee, should not apply to consumer debtors. Law No. 88-1201 of 23 December 1988 on Common Receivables Funds provides that the assignor remains obliged, apart from any guarantee obligation, to collect the receivables assigned (article 36) or to entrust collection on an obligatory basis to some other French credit institution or to the Bank for Official Deposits, advising the debtor of that action.

Consequently, France wants all the articles in this section II of chapter IV concerning the debtor to be "without prejudice to the laws of the State of location of the debtor concerning protection of the latter in transactions for personal, family or household purposes".

Coordination with the Unidroit draft Convention concerning interests in mobile equipment (article 36)

With regard to the relationship between the UNCITRAL draft Convention and the Unidroit draft Convention, it should be pointed out that article 36, which seems to apply the principle of "lex specialis derogat legi generali", does not seem to offer an appropriate means of settling a potential conflict between the two instruments in the event that the chapter on assignment of interests is maintained in the Unidroit draft Convention.

Chapter IX of the Unidroit draft Convention deals in effect with assignments of international interests. While, in most legal systems, a security is generally considered to be accessory to the receivable that is secured, in the system, proposed under the Unidroit draft Convention, the receivable constitutes the accessory security. The approach taken in the UNCITRAL draft Convention is altogether different [under article 12, the security right follows the secured obligation]. The UNCITRAL draft Convention deals with assignments of receivables in international trade and international assignments of receivables.

Let us recall that this question is to be considered at the next joint session of Unidroit and ICAO (Rome, 20 to 31 March 2000), which is to draft a convention on interests in mobile equipment, and that a working document on this subject prepared by the French delegation, which presents different options, is to be discussed. We, therefore, consider it preferable to await the results of the discussions, to be held under the aegis of Unidroit and ICAO, before trying to arrive at a final decision on this question within the framework of UNCITRAL, since the very existence of this chapter in the Unidroit draft Convention on assignments of interests is still contested.

Germany

[Original: English, German]

I. General comments

The German Government supports the objectives pursued with the UNCITRAL draft Convention on Assignment in Receivables Financing. Different national regulations on the requirements for effective assignments, on the status of the assignor, the assignee and the debtor, as well as different national regulations on the possibilities for global assignments and on the assignment of future receivables limit the cross-border use of receivables for financing

purposes. It seems to be necessary to remove legal uncertainties without disturbing existing financial practices.

The German Government welcomes the progress achieved to date on the ongoing UNCITRAL project, but notes that certain essential problems have not been resolved yet.

II. Specific comments

Scope of application/receivables other than trade receivables

The Working Group originally recommended a rather broad scope of application for the draft Convention. The German delegation supported this approach. During the discussion of specific provisions, however, it became clear that due to the particular nature of certain receivables, an unlimited scope of application would be unsuitable. This is the case with receivables from financial futures, loans on collateral securities, sale and repurchase schemes, and receivables processed through clearing systems.

Financial futures, loans on collateral securities, and sale and repurchase schemes are in practice concluded under master agreements. The aim of such agreements, in the event of non-performance or the insolvency of one of the parties, is to make possible the unitary termination and settlement (so-called "netting")[2] of all individual transactions. The master agreement restricts in particular any right which the insolvency administrator may have to make selective decisions. Thus, it is no longer possible for the insolvency administrator to fulfil individual (from the point of view of the insolvent debtor's assets as a whole) valuable transactions while terminating others (so-called "cherry-picking"). In order to secure the objective of the general agreement (i.e. the reduction of risks and the exclusion of "cherry-picking") or rather, to protect it from circumvention, master agreements, typically used in Germany and internationally, make provision that the assignment of receivables, arising from the individual transactions included in the agreement, made by one party requires the prior (written) consent of the counter-party.[3]

The above-explained "mechanics" of the termination and settlement as a whole can also be found in clearing systems which make provision for multilateral netting of the payments made through the system. The objective is the same as the one with respect to financial futures, loans on collateral securities, and sale and repurchase schemes, whereby within the framework of reducing risks, alongside the risks of insolvency, settlement risks are the most important consideration. In addition, all agreements on multilateral netting make provision for a limitation of assignability.

The German Government is of the opinion that established practices should not be hindered by the UNCITRAL draft Convention, and that a special regulation for the transactions concerned should, therefore, be introduced, either through a corresponding limitation of the scope of application of the draft Convention (solution of exclusion) or in the form of exemption of the relationship between debtor and assignor from the scope of certain provisions of the draft Convention (special-treatment solution).

In view of the recommendation of the Working Group to make the scope of application as broad as possible, it seems that it would not be possible to come to an agreement on the solution of exclusion. Within the framework of a special-treatment solution, which would in any case be necessary, a concept should be created which is transparent and easy to apply in practice. With respect to this consideration, the approach of excluding the above-mentioned receivables from the applicability of articles 11 and 12 of the Convention, where assignment prohibitions exist between the parties, would seem to be appropriate.

In any case, acceptance of such an approach will depend on whether the receivables to be covered by the special-treatment solution can be clearly identified. To this extent, recourse to the term "trade receivables" would appear to be problematic, particularly due to its reference to "financial services", since there is no uniform interpretation of the term under the different legal systems. Against this background, receivables resulting from financial futures, loans on collateral securities, and sale and repurchase schemes, as well as receivables which are processed through clearing systems, should be defined with due consideration to international practice (for example, the definitions in customary standard master agreements used internationally).

"Location" (article 6 (i)*)*

The term "location" is of central importance for the draft Convention, not only with respect to the scope of application but also with respect to certain provisions of debtor protection and certain private international law rules. To date, it has not been possible for the Working Group to come to an agreement on the definition of the term "location".

The German Government is of the opinion that the definition of the term "location" must be unequivocal, clear, always identifiable and do justice to the actual legal situation. Doubts exist with respect to article 6 *(i)* to the extent that it makes no distinction between head office and branch office. Only such a distinction will be able to take account of both European and international business practice, in which banks, in particular, are often active in foreign countries, not through subsidiaries, but through dependent branch offices.

If the provisions on the scope of application and on the relevant conflict-of-laws rules merely refer to the head office, one arrives at the unacceptable result that transactions which are made through foreign branch offices are subject

[2]The "mechanics" of netting can be described as follows: the individual transactions concluded within the framework of the general agreement constitute, together with the master agreement, one unitary obligation. Notice may only be given with respect to all transactions as a whole and only in certain cases (e.g. in the event of failure to make payment, of insolvency, of a worsening of the financial standing due to reorganization). It is not possible to give notice with respect to individual transactions. Where a general agreement is cancelled, all individual transactions are terminated. The reciprocal claims which arise as a result of this (e.g. for payment of money or delivery of securities) are reimbursed through a unitary settlement claim. The amount of the settlement claim is calculated on the basis of the current market values of the individual transactions. To the extent that positive and negative current market values are balanced against one another, these cancel each other out.

[3]Cf. for example section 7 of the ISDA Master Agreement 1992 as well as No. 10 of the German general agreement for financial futures. This requirement for consent is referred to hereafter as "assignment prohibition".

to the legal order of the head office, although the head office does not have any relation to the specific assignment in question.

For the above-mentioned reason, at the thirty-first session of the Working Group, it was suggested that reference be made to the location of the branch in the books of which a receivable appears immediately prior to an assignment. There are significant objections with respect to this proposal. At the point in time an assignment takes place, often the location, where the receivable is booked, cannot be determined. In addition, in an age of electronic media, the location of a book entry can often only be determined with difficulty; and, in the case of registers held transnationally, book entries may relate to receivables of branch offices in different countries.

Other issues of private international law (chapter V)

Provisions relating to private international law should be placed at the end in chapter V, if possible, and not in different places in the draft Convention. Accordingly, article 26 and the brackets around article 30 should be deleted. The Commission may need to examine whether the special public policy provision in article 30 (2) could also be deleted, since article 32 contains a general clause pertaining to public policy. Article 31 (2) is detrimental to legal certainty, since the meaning of the term "close connection" is vague and can be subject to debate. In this connection, the question arises whether one could not dispense with this provision as well.

Conflicts with other international agreements (article 36)

With respect to the issues addressed in article 36, it should be noted that the member States of the European Union have to pay regard to the fact that they are, under international law, already bound by article 12 of the Convention of 19 June 1980 on the Law Applicable to Contractual Obligations. In addition, it should be noted that legal instruments of the European Union (regulations and directives) of higher priority within the field of private international law (on the basis of articles 61 ff. of the Treaty on European Union in the version of the Treaty of Amsterdam) would not be affected by the draft Convention. In view of the above and of the complexity of article 36, the second half of that article may need to be deleted.

Furthermore, article 36 seems to create doubtful consequences for State Parties to the Ottawa Convention on International Factoring. According to the rule of speciality and notwithstanding its narrow scope of application, the Ottawa Convention might preempt the UNCITRAL draft Convention. As a result, States parties to the Ottawa Convention would be entitled to make a reservation to the rule validating assignments made in violation of contractual limitations (article 18 of the Ottawa Convention). With respect to factoring contracts outside the Ottawa Convention but within the scope of the UNCITRAL draft Convention, only the latter one is applicable. The non-applicability of the Ottawa Convention may be attributed to the specific nature of the contract, but it may also be attributed to the geographic sphere of application of the Ottawa Convention which is different from the geographic sphere of application of the UNCITRAL draft Convention. Even if the objectives of those Conventions do not differ, the provisions of the UNCITRAL draft Conventions are more comprehensive and contain more substantive law. Beyond that, the requirements for the assertion of claims are determined differently and the two conventions set out different regulations on assignment prohibition.

Similar problems will occur under the Unidroit/ICAO draft Convention on International Interests in Mobile Equipment and the Protocol on Matters Specific to Aircraft Equipment. An expert working group within the Unidroit/ICAO project will convene in early March this year. The German Government expects this group to present a solution to be acceptable for both projects.

Lithuania

[Original: English]

Title of the draft Convention

The title of the Convention should be "Convention on Assignment of Receivables in International Trade".

Exclusion of assignments for consumer purposes (article 4 (a)*)*

It would be more precise to state in article 4 *(a)* that the draft Convention is not applicable where the claim arising from the consumer contract is transferred to a consumer.

Treatment of receivables other than trade receivables (article 5)

Variant B of article 5 would be preferable.

Party autonomy (article 7)

The scope of article 7 seems to be doubtful. We think that the limitation to the principle of party autonomy should apply only with respect to the mandatory provisions of the draft Convention. For example, according to its content, article 13 should be regarded as a mandatory norm. Therefore, the parties should not be allowed to set it aside. The draft Convention contains further provisions of a mandatory nature which the parties should not have the right to derogate from. The draft Convention may become meaningless, if parties are able to introduce different rules than those of the mandatory provisions of the draft Convention. Thus, a reservation should be made in article 7 enabling parties to establish by agreement other rights and obligations, except in cases where the draft Convention determines the rights and obligations of the parties by way of a mandatory norm.

Time of assignment (article 10)

Article 10 of the draft Convention refers to the time of the conclusion of the contract of assignment. However, the time when a contract is deemed to be concluded is defined differently in the national legislation of various States. Therefore, it would be preferable to determine in the draft Convention the time when a contract of assignment is deemed to be concluded.

Contractual limitations on assignment (article 11)

Article 11 (1) is inconsistent with basic principles of Contract Law. Where the parties agree that the creditor will not relinquish the claim, such agreement is considered to be binding. A derogation from this principle might be possible only in relation to some specific contracts, like the factoring contract. However, it should not be established as a general rule applicable to all contracts. Article 11 (1) ignores a completely reasonable and legitimate interest of a debtor to deal with a specific creditor.

Principle of debtor protection (article 17)

In article 17, it would be useful to provide for the compensation of any expenses incurred by the debtor as a result of any alteration of the payment instructions.

Conflicts of priority (article 24)

The need for article 24 is doubtful. The purpose of the draft Convention is to unify the material law but not private international law. Therefore, the regulation of the issues of applicable law is hardly justifiable. Private international law issues could be decided within the framework of the Hague Conference on Private International Law.

Public policy exceptions (article 25)

Article 25 restricts significantly the possibility of applying the lex fori. We think that the draft Convention should allow the forum to set aside a rule of the applicable law if that rule is manifestly contrary, not only to the public policy of the forum, but also to mandatory norms of the lex fori.

Private international law provisions (chapter V)

We believe that chapter V should be omitted and the issues of the applicable law should be regulated by means of some other convention, since the draft Convention aims at the unification of material law but not of private international law and, in any case, under article 37 States may declare that they are not bound by chapter V.

Exceptions as to sovereign receivables (article 39)

Article 39 and other articles provide States with numerous possibilities for derogating from the application of one or more articles of the draft Convention. Such a wide possibility for derogation might reduce the effect of the draft Convention.

Peru

[Original: Spanish]

Title of the draft Convention

The most appropriate title of the Convention is: "Convention on Assignment of Receivables in International Trade".

Scope of application (articles 1 and 5)

In view of article 5, article 1, which establishes the scope of application, should specify that the draft Convention will apply only to trade receivables or, more precisely, to receivables arising from international commercial transactions.

"Future receivable" (article 6 (b)*)*

In article 6, the concept of "future receivable" should be covered by a separate subparagraph, in the same way as other terms defined in article 6.

"Location" (article 6 (i)*)*

Article 6 *(i)* should specify that it relates to the domicile of the persons involved in the assignment. In certain articles, for example articles 23, 24, 25 and 30, reference is made to "location". It should be specified that the concept being dealt with here is that of "domicile".

"Parts of receivables" (article 9)

Article 9 refers to "parts" of receivables. This term would need to be defined in article 6.

Form requirements relating to the creation of rights securing receivables (article 12 (5))

Article 12 (5) needs to be clarified, since it gives the impression that the provisions of the draft Convention will prevail over those of domestic law. In Peru, for example, mortgages and non-possessory liens or judicial liens need to be publicly registered, which in turn calls for certain formalities to be observed.

Defences and rights of set-off of the debtor (article 20)

Paragraph (3) refers [in the Spanish version] to article 10, whereas the reference should be to article 11.

Modification of the original contract (article 22)

Paragraph (1) is confusing. There appears to have been an error in the drafting since it states that an agreement concluded before notification of the assignment is effective, whereas such an agreement ought not to be effective. Subparagraph (2) *(b)* refers to a "reasonable" assignee, but it would be more appropriate to refer to a "diligent" assignee.

Law applicable to the relationship between the assignor and the assignee (article 28)

The provision set forth in article 28 (2) departs from the corresponding rule of private international law which is contained in the Peruvian Civil Code. According to the latter rule, if the applicable law is not chosen by the parties, the law of the place of performance of the contract is applicable or, if the contract is to be performed in different countries, the applicable law is that which governs the principal obligation or, if that cannot be determined, the law of the place where the contract was concluded. This comment also concerns articles 29 and 30, except as regards creditors of the assignor and the insolvency administrator, whose rights and obligations are regulated by a separate legal regime. This comment and that made with respect to article 12 (5) are qualified by articles 37 and 38, which make it possible for a State to declare, at its own discretion, that it will not be bound by those provisions.

Republic of Korea

[Original: English]

I. General comments

Korea considers that an international convention that aims to improve assignability of receivables in international transactions will enhance international trade and finance by making credit available at lower cost. Korea, therefore, supports the draft Convention that is currently discussed in the United Nations Commission on International Trade Law, provided that the draft Convention is effective in improving assignability of receivables and that it duly protects the rights of the parties affected by the assignment. While recognizing the economic objective of the draft Convention, Korea also notes that the rules on assignments of receivables have social and political implications which deserve serious considerations. In addition, Korea wishes to emphasize that certain domestic rules on the assignment of receivables are an integral part of the domestic legal system that cannot accommodate drastic changes. With these general observations, Korea wishes to make specific comments on the following issues.

II. Specific comments

The title, the preamble and the definition of receivables financing in article 6 (c)

Korea does not consider it necessary to limit the scope of the draft Convention to assignments in receivables financing. Korea is of the view that the draft Convention should apply generally to the assignment of receivables in international trade. Therefore, the title should reflect this idea, eliminating the term "financing" and replacing it with the words "international trade". The formulation of the preamble should be also aligned with this change. Consequently, Korea does not consider that the definition of receivables financing is necessary in the draft Convention.

Scope of chapter V (article 1 (3))

Korea considers that the scope of chapter V should be consistent with the scope of the draft Convention. Therefore, chapter V should apply to "assignments of international receivables and to international assignments of receivables as defined in chapter I."

Practices relating to the assignment of financial receivables (article 5)
and practices relating to the assignment of receivables arising from the sale or lease of aircraft and similar types of mobile equipment (article 36)

It is inappropriate to apply the draft Convention to certain financial transactions that are technically assignments of receivables but are not intended to provide credit (e.g. repurchase and swap transactions). The application of the draft Convention to those types of assignments will only interfere with the established practices and create confusion. Therefore, those transactions should be excluded entirely from the scope of application of the draft Convention.

The draft Convention should not include any rule referring explicitly to the assignment of receivables arising from the sale or lease of aircraft and similar types of mobile equipment to be covered by the preliminary draft Convention, currently prepared in the context of Unidroit. Korea is of the view that the relationship between those two Conventions should be left to be decided in accordance with the rules of international law. Any provision on the relationship between those texts, which is consistent with the rules of international law, would be redundant, while a provision, which would be inconsistent with the rules of international law, would only create a conflict.

"Location" (article 6 (i)*)*

The definition of "location" should be clear. At the same time, the definition should also designate a certain place as the location where the relevant transaction is actually agreed upon and takes place. Therefore, Korea can accept the place of business as the location. If the assignor or the assignee has more than one place of business, Korea proposes that the place of business is that which has the closest relationship to the original contract. Korea further proposes that the place of central administration is presumed to be such place in the absence of proof to the contrary. This proposition would provide a clear reference to "location" and would also accommodate a range of exceptional cases where transactions are agreed upon locally at a branch level, as is often the case with banking transactions.

Application of the annex to the draft Convention (article 40)

Korea prefers to provide for the application of the annex in line with the second bracketed proposal in article 40, since this proposal better clarifies the various options for States.

Other exclusions and effects of declarations (articles 39, 41 (5), 43 (3) and 45 (3))

Korea supports strongly the adoption of article 39, which allows States to exclude further practices from the application of the draft Convention. Financial systems of States are in significantly different stages of development. Certain financial practices are also considerably different from State to State. In addition, the fast development in the area of finance may make the application of the draft Convention to certain types of assignments of receivables inappropriate. Therefore, a State may find it inevitable to exclude certain practices from the application of the draft Convention. This indicates that the safety net provided by article 39 is essential. With respect to the effect of declarations, Korea wishes to adopt all bracketed proposals in articles 41, 43, and 44 of A/CN.9/466, annex 1 with the rest of the provisions in those articles.

A/CN.9/472/Add.1

Compilation of comments by Governments and international organizations

ADDENDUM

CONTENTS

STATES

Switzerland

[Original: English]

General comments

We have the honour to revert to the note of the Secretary-General of the United Nations dated 29 November 1999 concerning the draft Convention on Assignment of Receivables. We welcome the opportunity to comment on the draft Convention, noting with satisfaction that the Working Group on International Contract Practices of

UNCITRAL has accomplished an impressive piece of work. In particular, it can be expected that the draft Convention will remove obstacles to cross-border receivables financing and thus will facilitate such transactions. The draft Convention has been met with favourable initial reactions from the marketplace, indicating that the uniform rules correspond to practical needs.

We also observe that the draft Convention deals with all aspects of cross-border assignments in a comprehensive manner. We note, however, that the lack of a rule dealing with the form of an assignment could have a seriously disruptive effect on international trade practices. We are well aware that the issue has been discussed at great length, without the Working Group being able to reach a compromise. However, in view of the relative importance of the issue, we welcome any suggestion to address the issue, including suggestions to introduce options for Contracting States to choose from (such options could range from no form to written form requirements).

We shall limit our comments to the issues yet to be resolved at the Commission session as listed by the Secretary-General in the above-mentioned note.

Title/Preamble

With respect to the title, good arguments are put forward for the three options, but none of them is without shortcomings. It is essential to choose a title which relates to the broad scope of the draft Convention in international commercial assignments. The title should avoid to give the impression that important practices are excluded. We would, therefore, prefer a title which avoids any appearance that the scope of the draft Convention could be limited to assignments in receivables financing only and could read along the following lines: "Convention on Assignment of Receivables".

It is nevertheless desirable that attention is drawn to one of the most important aims of the draft Convention, namely to facilitate credit through receivables financing. The place to do this is the preamble and possibly also the commentary on the draft Convention. Thus, we prefer to retain the references to receivables financing in the preamble, including the examples for practices of receivables financing given in the third paragraph. Furthermore, language relating to this important aspect might be added in the commentary.

The term "receivables financing" is no longer used in the normative parts of the Convention, that is, all parts other than the preamble. Hence, the respective definition in article 6 *(c)* should be deleted.

Scope of chapter V (article 1 (3))

The need for and the scope of chapter V on private international law has been the subject of a very controversial debate. However, a majority of delegations were inclined to include such rules in the draft Convention due to the lack of private international law rules relating to assignments in many legal systems. From this approach follows necessarily that chapter V must apply independently of whether or not the assignor or the debtor is located in a Contracting State. It would, in fact, be difficult to justify the retention of this chapter for the sole purpose of filling gaps pursuant to article 8 (2).

For these reasons, we would like, in principle, to have the square brackets around article 1 (3) deleted. Nevertheless, regard should be had to the somewhat independent nature of chapter V which is in fact a convention within the draft Convention. An opt-in mechanism for chapter V, rather than the opt-out mechanism currently envisaged by articles 1 (3) and 37, would reflect this situation more appropriately.

Financial receivables (article 5)

It is essential to meet the specific needs of the financial services industry with respect to assignments in international banking practice. The question is whether such practices should be entirely excluded from the scope of the draft Convention or whether specific rules should be provided. Although at the beginning of the work of the Working Group the draft Convention was thought to cover essentially trade receivables, we have now a text before us, which is suitable to regulate all types of commercial transactions and which meets the interests of the financial services industry to a considerable extent. Hence, it appears appropriate to include a specific set of rules along the lines of article 5 insofar as assignments in banking practice differ from assignments of trade receivables. For reasons of consistency, exceptions to the general rules should be as limited as possible and clear. Variant B appears to better meet these criteria. Variant A is rather unclear in its language and might give rise to more interpretation problems, even if it introduces fewer exceptions to the rules of the draft Convention than variant B. Whereas we favour article 5 in general and variant B in particular, we nevertheless deem it preferable to provide a positive definition of non-trade receivables rather than only a negative one as set out in article 6 *(l)*. We are well aware of the difficulty in drafting a definition which is sufficiently broad to cover not only present practices but also future ones. However, we think that the matter is well worth further consideration by the Commission.

Definition of "location" (article 6 (i)*)*

The definition of the connecting factor "location" has been the subject of great disagreement and continued discussion among the delegations. This fact seems to suggest that no solution is completely without shortcomings. However, a number of elements have emerged that should allow the Commission to reach consensus. One element is the need for the use of objective criteria for the determination of location for the purposes of priority. For legal systems requiring publicity by means of registration to operate efficiently, third parties need to be able to determine easily the place in which they need to file or search. Another element is the flexibility in determining the location of the debtor for purposes of the application of the draft Convention. Yet another element, is the need to avoid departing from other uniform texts to a greater extent than is necessary.

Article 6 *(i)* satisfies most of these requirements and therefore constitutes a valid basis for further discussion. However, we are sceptical with respect to special rules for defining the location of branch offices of banks. First, it is unclear whether such special rules are necessary. Second,

in any event any special rules must satisfy the aforementioned principles, in particular that, for the purposes of the priority provisions of the draft Convention, any definition of location must turn around an objective criterion. A definition which relies on an entry into the books of a bank does not satisfy this requirement.

Proceeds (article 26)

With respect to article 26 on the law applicable to proceeds, we share the view that the concept of proceeds is a commercially sound one and should be addressed in the draft Convention. However, the way articles 24 and 26 are currently drafted could result in confusion and uncertainty. In particular, the relationship between article 24 *(b)* and 26 should be further clarified. Article 24 *(b)* deals with proceeds and the priority of rights in proceeds by way of a conflict of laws rule, subjecting "the existence and extent of the right ... in proceeds ..., and the priority ... in those proceeds" to the law of the State where the assignor is located. Article 26, on its face, deals with the same issues by way of a substantive law rule. In effect, article 26 provides a uniform rule with respect to an issue which, pursuant to article 24 *(b)*, is left to the national law of the State where the assignor is located. Hence, those rules deal with the same issue in a conflicting way and, therefore, need to be further clarified. One way to clarify this matter would be to leave the existence and extent of rights in proceeds to the law of the State where the assignor is located, but to require these States to recognize rights in proceeds at least as provided in article 26, that is, to read this latter provision as a minimal rule. As a result, legal systems that recognize rights in proceeds more generously would not be affected.

Furthermore, even though the concept of proceeds is sound from the point of view of commercial practice, we strongly suggest to avoid the term "proceeds". This term clearly emanates from common law systems. As a matter of principle, a uniform law should never use terminology which has an unequivocal meaning in a given legal system because users belonging to this system normally overlook the uniform character of such a rule while users in other legal systems might encounter problems to understand the rule. The term "proceeds" could be replaced by terms such as "payment" or "substitute".

Tunisia

[Original: Arabic]

Title

As indicated in its scope of application, the draft Convention regulates assignments by way of sale (for financing purposes, namely for obtaining value) and assignments by way of security (for obtaining credit). The title with the reference to "financing" does not adequately reflect the scope of the draft Convention, since it is limited to referring to assignments for financing (for value). Therefore, the title "Assignment of Receivables in International Trade" would be preferable, in particular, because it gives a complete indication of the scope and the objectives of the draft Convention. It would be advisable to adopt it and to exclude from the title any reference to receivables financing. It should be noted, however, that in the event that the reference to financing is retained, it would be preferable to redraft the title as follows: "Assignment of Receivables for Financing Purposes". Such a formulation would be more adequate and closer to the title in the French version ("*cession de créances à des fins de financement*").

Preamble

In the first paragraph, it would be advisable to replace the word "uncertainties" by the words "lack of clarity". In the second paragraph, the words "assignment of receivables" and the words "receivables financing" have been suggested. The first expression: "assignment of receivables" would be preferable because the matter relates to the assignment of receivables for the purposes of obtaining value as well as for the purpose of obtaining credit. In the fifth paragraph, it would be advisable to replace the words "affordable rates" by the words "affordable costs" and to avoid the repetition of language, caused by the word "facilitate" and the word "affordable" therein (only applicable to the Arabic version). The suggested change would make the meaning of this paragraph more accurate.

Scope of application (articles 1, 2 and 3)

In paragraph (2), the word "unless" should be replaced by the words "if [the debtor] is not [located] ... ". In paragraph (4), it seems that there is an error in the number of the article referred to in this paragraph. The correct number is 40 and not 36.

Articles 2 and 3 contain definitions of internationality and assignment respectively. They have no connection with the scope of application. Therefore, it would be advisable to insert them into article 6 on definitions. Subparagraph *(a)* of article 2 should be simplified as follows: "The creation of rights in receivables as security for a debt or other obligation is deemed to be an assignment."

Definitions (article 6)

In subparagraph *(e)*, in line with recent legislative trends allowing the use of modern means of communications, it would be advisable to use the words "information in a traceable written form" instead of the words "a communication in writing". Subparagraph *(j)* should be revised as follows: "'Law' means the law in force in a State, with the exception of the rules of private international law."

Effectiveness of assignment (article 10)

The words "at the time of the conclusion of the contract of assignment" should be replaced by the words "on the date of the conclusion of the contract of assignment."

Representations of the assignor (article 14)

Paragraph (2) should be revised as follows: "Unless otherwise agreed between the assignor and the assignee, the assignor may not be a guarantor as to the debtor's discharge by payment or to the debtor's financial ability to pay."

Public policy (article 25)

In paragraph (1), the words "the public policy of the forum State" should be replaced by the words "the public order of the forum State". It should be noted that, in the French version, the words "*ordre public*" are used.

Law applicable to the relationship between the assignor and the assignee (article 28)

Paragraph (3) should be revised as follows: "If the contract of assignment is connected with one State only, the fact that the assignor and the assignee have chosen the law of another State does not prejudice the application of the law of the State with which the assignment is connected, where the rules of its jurisdiction [do not permit agreement to choose the applicable law] [do not allow the application of its law to be excluded by agreement between the parties]."

Law applicable to priority (article 30)

This article is a repetition, in form and content, of the provisions of articles 24 and 25 and should, therefore, be deleted.

Application of the annex (article 40)

It seems that an error is made in the Arabic version of this article. Reference should be made to sections I and II or section III of the annex rather than the draft Convention. Before the words "this Convention", insert the words [of the annex to].

Article 43

In paragraph (3), the words "made on ... the date when the Convention enters into force" should be replaced by the words "made starting on the date on which this Convention enters into force".

INTERNATIONAL ORGANIZATIONS

Commercial Finance Association

[Original: English]

I. General comments

The Commercial Finance Association ("CFA") would like to take this opportunity to formally commend the Working Group on its hard work and continued dedication to this project. The UNCITRAL goal of facilitating the development of international trade through the availability of business financing at more affordable rates will most certainly be aided by the greater clarity and consistency that the draft Convention on Assignment of Receivables ("the draft Convention") will bring to the practice of assignment of receivables.

The current version of the draft Convention (A/CN.9/466, annex I) has made great progress at such clarity and consistency, while managing to balance the many and diverse legal systems and public policies of the participants. The specific comments noted below are offered by the CFA as an attempt to improve on this draft, in ways that are in harmony with the intent of those participants.

In addition, we would like to emphasize that, after completion and adoption of the draft Convention, there remains a need to make further progress in developing a public notice filing registry. The approach, currently included in the annex to the draft Convention, of permitting each State the option of adopting some form of notice registry system is an acceptable compromise necessary for the draft Convention to gain world-wide acceptance. However, it remains our firm belief that the transparency and certainty that a public registry system would provide in determining the existence and priority of competing claims are absolutely essential to the growth of receivables-based financing.

II. Specific comments

Subsequent assignments (article 1 (1) (b)*)*

Article 1 (1) *(b)* needs to adopt the same requirement for subsequent assignments as is done for initial assignments in article 1 (1) *(a)*. In order to have consistency in the application of whose legal regime applies to various assignments, for any subsequent assignment to be brought under the draft Convention, it must be clear that the assignor be located in a Contracting State. It is our belief that this has always been the intent of the Working Group.

Assignment of receivables other than trade receivables (article 5)

In light of the significant issues that still surround the possible application of variant A or B, or any alternative to

them, the CFA is unable to offer its opinion at this time. Further discussion is needed in order to better understand the concerns of other industries or business practices which might be impacted by the draft Convention.

Definition of "location" (article 6 (i)*)*

During the October 2000 session of the Working Group, the issue arose of whether a further refinement was needed for determining the location of a domestic branch of a foreign bank. Without any modification, the location would revert to the central administration of the bank itself, which could have impractical consequences. The U.S. delegation made the suggestion of focusing on the location of the entity on whose books the receivable is kept. This seems to be an acceptable solution, since this is in line with the normal practice of foreign branches. In addition, it could be easily included in standard assignment representations and warranties, mitigating the need for burdensome due diligence [discovery efforts] by the assignee.

Effectiveness and time of effectiveness of an assignment (articles 9 and 10)

The Commission would need to resolve the discrepancy in these articles as to the time an assignment of future receivables becomes effective. The time of effectiveness of the assignment of a future receivable needs to be tied to the conclusion of the contract of assignment, regardless of the fact that the receivable itself does not "arise" until a later date. This legal fiction is necessary not only for priority issues between competing assignees, it is critical for any bankruptcy analysis.

Contractual limitations on assignment (article 11)

The Commission would also need to address the question of the potential ability of the debtor to void the underlying contract. Since this could cripple the assignee's right to collect, it would be a major set-back to the intent of the draft Convention. Assignees understand that they must accept an assignment subject to any defences arising out of performance of the underlying contract. However, in light of the important intent of articles 11 and 12 of mitigating the impact of contractual anti-assignment clauses, permitting the debtor to use the breach of such a clause in an action against the assignor to nullify the contract itself would be totally contradictory to the supposed protection granted to an assignee in article 11 (2) who simply knew about the clause and decided to accept the assignment anyway.

Representations of the assignor (article 14)

Article 14 does not make clear whether representations are given only to the immediate assignee or also to any subsequent assignee. As a result, it is not clear whether any subsequent assignee may turn against the assignor for breach of representations. We think that it should be left to the parties themselves to determine who has the right to rely on the representations given. In the absence of express agreement to the contrary, the economic consequences of that decision of the parties should only flow to the immediate assignee.

Right to payment (article 15)

In trying to prevent an undue advantage to an assignee who violates an agreement with an assignor, article 15 (2) may be giving the debtor, or some other party, an unintentional windfall, if a notification given in violation of an agreement between the assignor and the assignee is ineffective for the purposes of articles 20, 22 or 24 to 26. While an assignee who wrongfully notified the debtor should not benefit from it, these severe consequences should not befall the assignee regardless of the type or severity of the violation. At minimum, some limiting language should be added tying the violation to the penalty. The following phrase might be added in article 15 (2): ", if the provision of the agreement that was violated was intended to have a contrary effect."

Law applicable to competing claims (article 24)

There may very well be a significant discrepancy between the language of paragraph *(a)* (i) and the intent of the Working Group in determining the extent and priority of the right of an assignee vis-à-vis competing assignees. The prerequisite for applying this subsection is that the assignees must have received their assignments of the *same* receivable from the *same* assignor. In a chain of subsequent assignments (very probable in syndicated loans and asset securitization transactions where co-lenders and investors get their undivided interests through the means of a separate assignment), the ultimate assignee technically does not get its assignment from the same assignor. Therefore, if the draft Convention were interpreted literally, there would be no substantive rule in the draft Convention governing the competing claims of that assignee in competition with an assignee that, for example, received its rights in an assignment from the original assignor.

It is our belief that the Working Group did intend to cover this situation, based on the rationale that any subsequent assignments are derived from the original assignment and are thus, in the eyes of the Working Group, from the "same" assignor. Yet nowhere in the draft Convention is there any qualifying language applied to the term "assignor" causing one to distinguish between the original or any subsequent assignor. In fact, quite the opposite, article 2 *(b)* was inserted to make it clear that the term could be used to refer to the initial or any subsequent assignor. A resolution of this problem might be to include clarifying language in the commentary, or revise the text of article 24 *(a)* (i) in order to show that the assignment came, directly or indirectly, from the same "original" assignor.

Article 36

The CFA strongly believes that no exception should be made for receivables arising from the sale or lease or mobile equipment to be covered by the draft Convention on International Interests in Mobile Equipment, currently being prepared by Unidroit. The more inclusive and comprehensive nature of the draft Convention requires that it be given priority.

European Banking Federation*

[Original: English]

I. General comments

The UNCITRAL Working Group on International Contract Practices, entrusted with the preparation of a uniform law on assignment of receivables, adopted at its last session in Vienna in October 1999 a draft Convention for submission to the Commission's session in New York in June 2000. In this draft Convention, the issues of the treatment of financial receivables and of the meaning of "location", amongst others, remain pending and the European Banking Federation is pleased to have the opportunity to put forward its views on these matters.

We welcome the initiative of UNCITRAL in drawing up this draft Convention and believe that the harmonization of the law governing the assignment of receivables will considerably improve the availability of credit to support world trade. We believe, however, that it is important that the provisions of the draft Convention do not inadvertently disrupt the legal basis of widely used financial contracts and the availability of credit in support of trade. Therefore, we propose that these issues left pending by the Working Group should be resolved as follows:

1. The effectiveness of non-assignment agreements relating to financial receivables should be preserved where they form an inherent part of the transaction structure, a more limited exception than that in the current draft.

- In article 5, variant B is to be preferred, but the scope of the exception should be limited to articles 11 and 12, and only to cases where the debtor has not consented to the assignment.

2. The definition of "location" should be consistent for all parties—assignor, assignee or debtor—and should make provision for branch offices.

- In article 6 *(i)* the "location" should be geared uniformly for the assignor, assignee and the debtor—and not only for the debtor—to the *"place of business most closely connected"* to the contract.

3. The overriding importance of international efforts to combat money laundering should be specifically acknowledged in the payment provisions.

- Article 19 should apply to assigned deposit accounts only to the extent that the deposit-taker is able to comply with relevant identification requirements.

II. Drafting proposals

Limitation on receivables other than trade receivables (article 5)

We propose that variant B be adopted, with the addition of the words "unless the debtor consents" and with the deletion of the words "...and section II of chapter IV..." so that the text would now read (changes in italic):

"*Unless the debtor consents,* articles 11 and 12 apply only to assignments of trade receivables. With respect to assignments of receivables other than trade receivables, the matters addressed by these articles are to be settled in conformity with the law applicable by virtue of the rules of private international law."

Definitions and rules of interpretation (article 6)

We propose an amendment to article 6 *(i)* to make the definition of "location" consistent for all parties, assignor, assignee or debtor, so that this definition reads (changes in italic):

"*(i)* (i) a person is located in the State in which it has its place of business;

(ii) if the assignor or the debtor has more than one place of business, the place of business is that which has the closest relationship to the original contract;

(iii) if the assignee has more than one place of business, the place of business is that which has the closest relationship to the assignment contract;

(iv) if a person does not have a place of business, reference is to be made to the habitual residence of that person."

We propose an amendment to article 6 *(l)* to give greater clarity to matters excluded from the definition of "trade receivable", so that this definition reads (changes in italic):

"*(l)* "trade receivable" means a receivable arising under an original contract for the sale or lease of goods or the provision of services *other than receivables arising under payments or securities settlement systems and receivables arising under financial contracts governed by netting agreements or used as collateral.*"

We also propose the addition of three further definitions in article 6:

"*(m)* "payments or securities settlement system" means any contractual arrangement between three or more participants with common rules

*The European Banking Federation represents the interests of more than 3,000 banks in the EU and in Switzerland, Norway and Iceland.

- The definition of "trade receivable" in article 6 *(l)* should be amended to exclude receivables arising under payments or securities settlement systems and receivables arising under financial contracts governed by netting agreements. Definitions of "payments or securities settlement system", "financial contract" and "netting agreement" should be added.
- "Financial contract" should be defined sufficiently broadly so that the exclusion applies to the common practice of financial institutions of providing credit facilities using a deposit or securities account as collateral, but not to such accounts more generally.

for the settlement of payment or security transfer orders, and of any related collateral, between the participants, whether or not supported by a central counter-party, settlement agent or clearing house.

"*(n)* "financial contract" means any spot, forward, future, option or swap transaction involving interest rates, commodities, currencies, equities, bonds, indices or any other financial instrument, any repurchase or securities lending transaction, any deposit transaction and any other transaction similar to any transaction referred to above entered into in financial markets and any combination of the transactions mentioned above, and any collateral or credit support related to any transaction referred to above.

"*(o)* "netting agreement" means an agreement which provides for one or more of the following:

(i) the net settlement of payments due in the same currency on the same date whether by novation or otherwise,

(ii) upon the insolvency or other default by a party, the termination of all outstanding transactions at their replacement or fair market values, conversion of such sums into a single currency and netting into a single payment by one party to the other, and

(iii) the set-off of amounts calculated as contemplated by the preceding phrase (ii) under two or more netting agreements."

Debtor's discharge by payment (article 19)

We propose that paragraph (5) should be amended so that it reads (changes in italic):

"(5) If 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, where the receivable is a deposit, to comply with any requirements imposed to prevent money laundering as if the assignee were a depositor*, 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."

III. Specific comments

1. Why are banks and other financial institutions concerned about preserving the efficacy of non-assignment agreements in financial transactions?

At first sight, it might appear that a bank or other party to a financial transaction is in no different position from any other debtor in relation to any other transaction. But this is not the case. Many financial transactions involve credit risk and assignment increases not only the credit risk involved, but also the security, litigation, insolvency and regulatory risks involved.

For example, a bank provides a letter of credit via its correspondent to a third-party exporter on behalf of its importer customer against an undertaking by the customer to reimburse the bank for any amount paid under the letter and with the security of a deposit by the customer. The bank will use the deposit in the event that the customer fails. If the customer assigns the deposit to an assignee before failing, the assignee may request payment from the bank, leaving the bank to claim against its customer, a credit risk for which the bank had not contracted (that was, after all, why it took the deposit as security). In this case, a non-assignment condition on the deposit is an inherent part of the transaction and, if its efficacy is called into question, such arrangements will no longer be made available to customers.

Another typical transaction is an interest-rate swap where payments indexed to a fixed rate by one party are netted against payments indexed to a variable rate by the other to leave a flow in either direction. In this case, the credit exposure can vary during the life of the swap as interest rates change, and the individual payments before netting are often very large compared with the net amount actually paid.

Netting agreements extend this concept to cover a whole range of transactions and offset all the cash-flows and obligations to one net figure per currency for settlement purposes and one single figure in the event of default, including liquidation of either party. Within such an agreement, an assignment of an individual "receivable" would be a fundamental change to the structure and, for this reason, is generally subject to the prior consent of the other party to the agreement. The breach of such a clause of prior consent constitutes an event of default triggering the winding up of the whole agreement. As a result of "cross-default" clauses which are included in many financial agreements, a default on one such agreement will cause all other agreements to be terminated with potentially fatal consequences for the customer and considerable risk to the financial institution whose whole portfolio structure may be disrupted.

The regulatory treatment of netting agreements is a significant factor in the willingness of banks to enter into transactions. Regulators recognize the reduction in credit risk by allowing a corresponding reduction in required capital and this, in turn, makes the transaction available to the customer at a lower price. But regulators will only accept netting as effective if the bank has obtained a clear legal opinion that the agreement will achieve the netting before, during and after insolvency. If doubt is expressed in the opinion as a result of uncertainty about the application of the draft Convention, the netting agreement will not be treated as effective for regulatory purposes, the capital benefit will not be available and the cost of the transaction will rise.

In addition, the assignment of certain types of receivables without the debtor's consent may lead in certain circumstances to inadvertent breach of national regulatory provisions. In some situations, such a breach may involve

civil and criminal liability for the debtor. For example, a debtor may find itself in technical violation of United States security or commodity law (such as that applying to public offerings) if an assignor is able to assign certain types of transactions, such as repos, securities lending or currency swaps, originally contracted outside the United States, to an assignee located in the United States.

All these factors of uncertainty would undoubtedly lead to a reluctance among financial operators to use these financial instruments and this would reduce availability of credit for trade and thereby undermine the principal objective of the draft Convention.

2. Are these concerns not met by the debtor-protection provisions in section II of chapter IV, or by the wording proposed in variant A of article 5?

Although one of the most important debtor-protection provisions in section II of chapter IV (article 20) states that any assignment is subject to existing rights of set-off, the way in which the provision is framed means that it does not seem to extend to close-out netting mechanisms typically included in netting agreements, which are still contingent on a default and include all existing and future transactions within their scope. Also, close-out netting is not always accomplished using set-off as a legal mechanism.

Variant A of article 5 would allow the assignment of financial receivables but would provide that the rights and obligations of the debtor would not be affected in the absence of consent. The result of this complex combination would be that the assignment would be valid as between the assignor and the assignee but the debtor would be ostensibly unaffected. In the event of liquidation of the assignor, the debtor would also be a creditor and the assignee might dispute the priority of the debtor's claim in the liquidation. Article 24 provides that this dispute would be decided according to the law of the State where the assignor is located. Although the debtor might be successful in refuting the assignee's claim, this is an unnecessary expense and the prospect of potential litigation will discourage financial institutions from entering into such contracts. It is also unrealistic to give purported effectiveness to an assignment in a context where such an action is inappropriate.

Whilst the regime proposed in variant B is clear, the one proposed in variant A is likely to constitute a factor of high legal uncertainty for the financial markets.

3. Why remove reference to section II of chapter IV from variant B of article 5?

If a receivable is not a trade receivable, article 5, variant B with the suggested revisions, would disapply articles 11 and 12. If as a result, an assignment is not effective because of an agreement not to assign without the debtor's consent which has been withheld, there is no assignment and chapter IV has no application. If, on the other hand, there was no need for the debtor's agreement or that agreement had been obtained, the provisions of chapter IV should apply as to any other receivable. We have no wish to reduce the scope of the draft Convention any more than is necessary to protect the transactions about which we have concerns.

4. Why change the definition of "trade receivable" in article 6 (l)?

The purpose of the amendments proposed to article 6 on definitions is to limit the scope of the exclusion of financial contracts. The original wording for the definition of "trade receivable" would have excluded "financial services", a term that is both extremely wide in its scope and also difficult to define. By excluding only receivables arising under payments or securities settlement systems, or under financial contracts governed by netting agreements or used as collateral, we propose to narrow the scope of the exclusion and limit it to certain categories of contracts or payments that are subject to netting or collateral arrangements necessitated by insolvency considerations, and mandated by international financial supervisory standards (including capital adequacy rules).

It is common for financial institutions to use deposits or securities as collateral for trade credit purposes. In such circumstances, the assignment of the deposit or securities is subject to the debtor's consent. To allow the account holder to assign such deposit or securities without restriction would strongly diminish the value of deposits or securities as collateral, which would in turn create as many difficulties for trade finance as the proposed draft Convention is designed to avoid.

5. Are the additional definitions required?

We believe that the additional definitions proposed in draft article 6 *(m)*, *(n)* and *(o)* improve considerably the clarity of the draft Convention and ensure that the scope of the exclusion for financial receivables is no wider than it needs to be to meet our concerns.

6. How is assignment affected by money-laundering prevention measures?

The international community has made the prevention of money laundering a key element of the fight against drug trafficking and other serious crimes. Financial institutions have been made subject to specific requirements amongst which are those of customer identification and the establishment that funds have been received from a bona fide source. Deposit-taking institutions cannot agree to assignments of deposits to third parties unless they are able to complete the requisite identification and probity checks.

Our concern relates to fraud or misuse of funds. Suppose depositor Mr. Smith assigns the deposit to Mr. Jones. A person presents himself at the bank, says that he is Mr. Jones and provides a letter signed by Mr. Smith confirming the assignment. He then requests the bank to pay the deposit to him in cash or by international transfer to a third party. The bank is at risk of being a party to unlawful conversion of the funds, just as it would be if it dealt with a cheque from Mr. Smith in this way. Banks protect themselves by insisting on proper identification of Mr. Jones before accepting cheques payable to him. These identification checks are incorporated in the "know your customer" element of money-laundering rules, rather than the suspicious transaction element.

Article 19 appears to override the bank's right to insist on identification. There is protection in article 19 (5) that the debtor can demand written evidence that the assignment was made, but this does not solve the assignee identification problem. The change proposed to article 19 would clarify that the provisions of the draft Convention are not in conflict with money-laundering prevention requirements.

The proposals in our draft are, in practice, modest in effect.

- Most deposits will not involve an anti-assignment clause, so the question of the debtor's consent does not arise. Where there is an anti-assignment clause because the deposit is used as collateral, the same arguments as for netting agreements apply.
- Banks will generally insist on identification of the assignee, so the added words in article 19 (5) merely protect the bank and avoid any potential dispute. Again, most assignments are likely to be to other financial institutions, so the need for identification will be infrequent.

7. Why amend the definition of "location"?

Financial institutions are involved in assignments as debtors, assignors and assignees, and nearly all financial institutions operate through branches which generally transact business under local law and jurisdiction. We are, therefore, particularly interested in the provisions for determining the location of a party with more than one place of business. We believe that in the case of several places of business, the place which has the closest relationship to the contract must be preferred to that of the central administration currently stipulated for the assignor and the assignee in article 6 *(i)* (ii). This criterion of "central administration" is particularly questionable as far as the assignor is concerned, basically for three reasons:

- First, in cases where the assignor is affiliated to an internationally operating group, it is not ipso facto clear to outsiders whether the contractual relationship is entered into with a dependent branch or with an independent subsidiary.
- Secondly, reference to the central administration (or head office) may result in an assignment that is carried out through the branch of a company outside the country where that head office is located (being classified as an "international assignment"), even if this branch as well as the assignee and the debtor are all established within one legal regime which is different from the one where the head office is established. This would lead to the application of a legal regime which has no real connection to the contract.

  For example, a company whose head office is established in France assigns a receivable through its branch established in Germany. The assignee and debtor are also located in Germany. Any reference to the head office (or central administration) would lead to the application of French law notwithstanding the fact that France has no real connection to the contract.
- Finally, reference to the head office means that where competing law is concerned, application of the legal regimes of the head offices would be encouraged without taking into account any inherent legal connection of such regimes with the transactions involved.

A consistent definition of "location" for all parties to a transaction (assignor, assignee and debtor) will accord more closely with business reality and help to prevent any questions of competing legal regimes arising.

Financial Markets Lawyers Group*

[Original: English]

The Financial Markets Lawyers Group wishes to endorse the recommendations recently made by the European Banking Federation ("EBF") to improve the text of the UNCITRAL draft Convention on Assignment adopted by the Working Group on International Contract Practices ("the Working Group") at its last session in Vienna in October 1999 ("the draft Convention"). We applaud the efforts of UNCITRAL to facilitate greater cross-border trade financing and believe that adoption of the draft Convention will lead to greater harmonization of the rules currently governing cross-border assignments of receivables.

We believe, however, that the draft Convention should not undermine the legal basis upon which international over the counter ("OTC") financial markets contracts are currently entered into and used as collateral. As the Working Group has been made aware, the standardized agreements presently used by OTC market participants generally include a provision expressly prohibiting the assignment of any underlying rights or obligations by one counter-party without the prior written consent of the other counter-party and provide for certain rights and obligations of the parties with respect to collateral.

*The Financial Markets Lawyers Group ("FMLG") is organized as an independent body under the sponsorship of the Federal Reserve Bank of New York ("FRBNY") and is made up of representatives of the various United States and European commercial and investment banks that are active in the over the counter ("OTC") foreign exchange markets. The FMLG's primary responsibility is to coordinate various legal projects undertaken by the New York Foreign Exchange Committee ("FXC"). The FXC, which was likewise organized under the sponsorship of FRBNY, represents many of the most significant participants in worldwide foreign currency trading. The FMLG is also responsible for drafting legislation aimed at enhancing the integrity of financial markets and for preparing papers and model contracts on specific market-related topics.

These provisions lend certainty and predictability to the set-off and netting provisions of these agreements and thereby enable market participants to better manage their counter-party credit risk.

As a result, we agree with the EBF's suggested changes to the draft Convention and encourage the Commission to incorporate the defined terms "financial contract" and "netting agreement" into the draft Convention using the language suggested by the EBF. For purposes of clarification, however, we would like to note that it is our understanding that the EBF's definition of the term "netting agreement" is intended to include master netting agreements (such as those currently published by the FXC) that allow a party to close-out some but not necessarily all of the underlying transactions in certain situations.

We also share the EBF's view that the draft Convention should not apply to receivables arising from the operations of a payment or securities settlement system. Allowing participants of a securities or payment settlement system to assign their receivables is obviously likely to substantially undermine the fluid operations of such systems and impair the certainty and finality of settlements. We, therefore, agree with the EBF's recommendation that such receivables should be more clearly excluded from the scope of the draft Convention.

In short, we urge the Commission to endorse the textual changes suggested by the EBF in its comments. Again, we commend the Commission's efforts to develop a legal regime under which global trade financing can better flourish. We would be prepared to provide the Commission with any further information it may require.

Europafactoring

[Original: English]

"Location" (article 6 (i)*)*

The issue of location of the assignor and the assignee is still an open matter, whereas the issue of the location of the debtor has been settled in a reasonably satisfactory way. The central administration rule will lead to predictable results with respect to the application of the draft Convention. However, if the assignor has a place of business (branch office) in a contracting State and a central administration in a non-contracting State, the draft Convention will not apply. The exception proposed with respect to branch offices of financial institutions is intended to reflect the idea that the scope of application of the draft Convention should be as wide as possible and to ensure that the draft Convention would apply to the cases just mentioned. We welcome that idea. However, there are two problems with the proposed exception. Firstly, an exception for branches of certain industries would be difficult to define (should banks be exempted, or financiers, or financiers and insurance companies, and under which law would be determined whether a specific business is a banking business). As a result, uncertainty would arise as to the application of the draft Convention.

On the other hand, the merits of such an exception would be limited. In view of the fact that the law applicable to priority issues is to be determined by reference to the location of the assignor, the exemption would result in the application of the priority rules of the country in which the branch office is located. It is not certain that such priority rule would be recognized in the country in which the central administration of the assignor is located, and in which insolvency proceedings would likely be commenced. As a result, in order to be protected, the assignee would have to also comply with the priority rules of the country in which the central administration is located.

It might seem strange to business, but a receivable arising from a contract with a branch office is, legally speaking, a receivable vested in the legal entity located at its central administration. With respect to factoring, the importance of the envisaged exemption is minor, as factoring companies and their clients have places of business in countries, in which adoption of the draft Convention can be expected. With respect to banks with central administration in a tax haven (which would normally not adopt the draft Convention) and branch offices in financial centres, again the importance of this exemption would be minor, at least to the extent that such banks are likely to act as assignees rather than assignors (and their location would not play a role in the determination of the law applicable to priority).

It might seem a futile task to determine the different possibilities with respect to the application of the rule on location and the exception as to branch offices. However, we have tried to find, at least, a way to systematize and understand the solutions agreed on so far. In this context, we would note that, while the location of the assignor in a contracting State is important for determining the scope of application as well as the applicable priority rules, the location of the assignee or the debtor is of no importance for those matters (with the exception of the question of internationality).

If mainly the location of the assignor matters, it would be wise to first establish to what extent business is affected by the rule and to decide accordingly as to any exceptions. The Commission may wish to focus on only a small number of cases with respect to receivables originating in the country in which the assignor is located and leave aside subsequent assignments to which, by virtue of the subsequent assignment rules, the draft Convention would apply for the reason that an international assignment had preceded.

Assignor	*Branch office*	*Assignee*	*Branch office*	*Scope*	*Priority according to Convention*	
In contracting state (in)	In	In contracting state	None	Yes	Yes	Transaction from main office
	Out			Yes	Yes	
	None			Yes	Yes	
In non-contracting state (out)	In			No	No	
	Out			No	No	
	In			Yes	Yes	Transaction from branch office
In		In	None			
	Out			To be debated (yes)	To be debated (no)	
Out	In			To be debated (yes)	To be debated (no)	
	Out			No	No	
	In		None	Yes	Yes	Transaction from main office
In		Out				
	Out		In	Yes	Yes	
	None		Out	Yes	Yes	
Out	In		In	No	No	
	Out		Out	No	No	
	In		In	Yes	Yes	Transaction from branch office
In		Out				
	Out		Out	To be debated (yes)	To be debated (no)	
	In		In	To be debated (yes)	To be debated (no)	
Out						
	Out		Out	No	No	

Form of assignment

The draft Convention does not contain any substantive rule on the form of assignment. To ensure certainty, at least as to the law applicable to form, the draft Convention should specify that the law of the country in which the assignor is located governs form requirements. Such an approach would be consistent with the approach followed with respect to the law applicable to priority issues. The draft Convention should also clarify that, wherever a written assignment is required, writing would be understood in accordance with the draft Convention, namely it would include electronic means of communication, even if such means are not recognized in the country of the assignor's location.

Financial receivables (article 5)

We have always welcomed the idea that the draft Convention should be aimed at improving the extension of credit at a lower cost, while not interfering with practices already available in the market. If such existing practices can be defined properly and isolated from practices involving the financing of trade receivables, such as factoring, we would not oppose any specific rules as to such practices. In this context, it is a matter of discussion whether the draft Convention or only certain provisions (e.g. articles 11 and 12) should not apply to such practices. The adoption of the draft Convention may be opposed by an industry group on the ground that specific exemptions were granted to one and not another group. However, based on the experience gained in the context of the adoption of the Ottawa Convention on International Factoring ("the Ottawa Convention") in Germany, which was opposed by certain groups solely on the ground of the anti-assignment clause rules, we would note that excluding certain financial practices from the scope of the draft Convention altogether may increase the acceptability of the draft Convention.

Relation to other international texts (article 36)

For policy reasons, it may be wise to subordinate the draft Convention to other conventions and, in particular, to the Ottawa Convention. The scope of the Ottawa Convention is very narrow (it does not even cover all factoring operations) and the rules of the two Conventions may be similar. However, such an approach would result in uncertainty. The parties may exclude the application of the Ottawa Convention as a whole (the UNCITRAL draft Convention does not allow such a total exclusion). If the parties exclude the application of the Ottawa Convention, the question arises whether the UNCITRAL draft Convention or national law would apply to fill the gap. Furthermore, the Ottawa Convention allows certain reservations with respect to the rule on anti-assignment clauses and two States have made such a reservation.

A regime with national and international rules and exceptions as to anti-assignment and with international rules with different content and scope of application would not be conducive to legal certainty or consistent with the main objectives of the draft Convention. In view of the above, while praising the draftsmen of the draft Convention for their modesty, we would suggest, with due respect to the Ottawa Convention, that the draft Convention should supersede the Ottawa Convention. To the extent that the draft Convention is widely adopted, such an approach would ensure certainty in all types of factoring operations universally. We reserve further comments until we have the opportunity to read the comments of Governments and other organizations. Subject to the invitation of UNCITRAL, we will be represented at the Commission session in June 2000 and we would welcome any comments on the ideas mentioned above.

International Institute for the Unification of Private Law (Unidroit)

[Original: English]

I. General comments

The Unidroit secretariat takes this opportunity to compliment the Working Group on the excellent work it has accomplished in this difficult area. In general, it notes the indirect recognition of the debt owed by the draft Convention to the Unidroit Convention on International Factoring (A/CN.9/466, para. 193) and would suggest that consideration might usefully be given to this debt being acknowledged more explicitly in the preamble to the draft Convention, for instance, by the introduction of a clause indicating that the draft Convention has built on the achievements of the Unidroit Convention. It notes furthermore the statement that "according to general principles of treaty law, the draft Convention would not prevail over the Ottawa Convention on the grounds that the Ottawa Convention was a more specific convention" (A/CN.9/466, para. 194). We would suggest that as much be noted in any explanatory memorandum that may be prepared in due course with respect to the draft Convention once adopted.

II. Specific comments

Relationship between the draft Convention and the preliminary draft Unidroit Convention on International Interests in Mobile Equipment and the preliminary draft Protocols thereto

Regarding the relationship between the draft Convention and the preliminary draft Unidroit Convention on International Interests in Mobile Equipment ("the preliminary draft Convention") and the various preliminary draft Protocols thereto under preparation, namely a preliminary draft Protocol on Matters specific to Aircraft Equipment ("the preliminary draft Aircraft Protocol"), a preliminary draft Protocol on Matters specific to Railway Rolling Stock and a preliminary draft Protocol on Matters specific to Space Property, the Unidroit secretariat would first note that this matter was referred to the Public International Law Working Group set up at the Second Joint Session of the Unidroit Committee of governmental experts and the subcommittee of the ICAO Legal Committee considering the preliminary draft Convention and the preliminary draft Aircraft Protocol, held in Montreal from 24 August to 3 September 1999. The Public International Law Working Group held a first session in Cape Town and on the Blue Train en route to Pretoria from 8 to 11 December 1999. A further session of that Working Group is to be held during the Third Joint Session, to be held in Rome from 20 to 31 March 2000, after which the Report of the Working Group will be considered by the Plenary.

In its preparation of the preliminary draft Convention and the various preliminary draft Protocols thereto, the authors of these texts have at all times striven to avoid entering into conflict with the draft Convention. Evidence of this concern is to be seen in the delimitation of the preliminary draft Convention by reference to interests in mobile equipment protected by registration against identified assets. A decision was taken early on not to go for a debtor-based registration system and not to deal with perfection requirements and priority rules relevant to receivables financing detached from the underlying asset.

The sphere of application of the preliminary draft Convention was from the outset delimited by reference to categories of high-value mobile equipment that were by their nature likely to be moving across or beyond national frontiers on a regular basis in the ordinary course of business and that were capable of unique identification. The view was taken that such a limited coverage might reasonably be expected to make the new international regimen more acceptable to those States for which its innovations might raise the most difficulties. Up until the First Joint Session, held in Rome from 1 to 12 February 1999, the preliminary draft Convention accordingly contained a list of the specific categories of mobile equipment intended to be caught by its provisions (airframes, aircraft engines, helicopters, registered ships—the coverage of which was however only provisional, oil rigs, containers, railway rolling stock, space property) as well as a residual category of "other categories of uniquely identifiable object" (cf. Study LXXII-Doc. 42, Article 3 *(a)-(i)*).

It is true that this list no longer features in the preliminary draft Convention and it is the considered opinion of the Unidroit secretariat that therein lies the cause of some of the past difficulties encountered by members of the UNCITRAL Working Group in envisaging the exclusion from the draft Convention of the assignment of receivables to the extent that these become associated rights in connection with the financing of those categories of mobile equipment encompassed by the preliminary draft Convention.

Paragraph 85 of the Report by the Working Group (A/CN.9/466) gives the distinct impression that it was essentially the prospect of the potentially infinite scope of such an exclusion, opened up by the decision of the First Joint Session to delete the aforesaid list from the preliminary draft Convention, which had made it most difficult for the Working Group to agree to such an exclusion. For this reason, the Unidroit secretariat intends to propose to the forthcoming Third Joint Session that it reintroduce the list deleted at the First Joint Session.

In these circumstances and on this basis, the Unidroit secretariat's preferred solution would be that the draft Convention specifically exclude from its sphere of application the assignment of receivables to the extent that these become associated rights in connection with the financing of those categories of mobile equipment encompassed by the preliminary draft Convention. The different categories of mobile equipment which it contemplates are of a kind traditionally recognized as enjoying special status. Various aspects of the structure of the proposed new international regimen correspond to the specificity of the categories of equipment covered. Firstly, each category of equipment covered by the preliminary draft Convention will be the subject of a separate Protocol, which will contain those rules that are necessary to adapt the general rules of the preliminary draft Convention to the special characteristics particular to the financing of each such category. Secondly, for the registration of each category of equipment and the establishment of priority ranking as between each such registration a separate International Registry will be created. An insistence on the specificity of the assets covered by the proposed new international regimen has been a recurring feature of Unidroit's work on this project to date.

Independently of the foregoing, the aviation working group, the rail working group and the space working group respectively have all called for an exclusion from the sphere of application of the draft Convention of the assignment of receivables to the extent that the receivables become associated rights in connection with the financing of those categories of aircraft equipment, railway rolling stock and space property encompassed by the preliminary draft Convention as implemented by Protocols thereto. Those groups have been established under the authority of Unidroit in order to monitor the application of the preliminary draft Convention to aircraft equipment, railway rolling stock and space property and to act as a conduit for the expertise of each sector. They are made up of representatives of manufacturers, users and financiers as well as of the international organizations concerned.

The aviation, rail and space working groups have all enunciated a clear desire that assignments of receivables taken as security in aircraft, rail and space financing transactions should be dealt with in equipment-specific instruments, namely the preliminary draft Convention as implemented by the relevant preliminary draft Protocol, rather than in the draft Convention. The aviation working group in particular emphasized the strong interest of the aviation industry in establishing a single regimen that reflected aircraft financing practices and structures.

The value of assets like aircraft equipment, railway rolling stock and space property lies in the income that may be realized from the sale or lease thereof. It would undermine the concept underlying the preliminary draft Convention if the debtor could assign receivables derived from such an asset under a system different from that applicable to the pledging or other encumbering of the asset. The indivisibility of the asset and the income that may be realized from the sale or lease thereof is clearly enshrined in articles 8 (1) and 10 of the preliminary draft Convention, relating to rights on default, and article 14, relating to interim relief.

In the case of aircraft, rail and space financing structures there is an inextricable link between the aircraft equipment, railway rolling stock and space property, on the one hand, and the associated receivables, on the other. In the case of space financing structures, for instance, much of the value placed on a satellite is derived from the various rights associated with the operation of that satellite, in particular the associated receivables. Such rights are an essential element of the commercial value of a satellite and without such rights the satellite will have very little commercial value. It is, therefore, appropriate for security rights relating to both the asset and the associated receivables to be subject to a common regimen, in the interest of avoiding not only conflict of laws problems but also the resultant lack of commercial predictability and increases in transaction costs.

Against the alternative solution, which would consist in allowing the preliminary draft Convention and the various preliminary draft Protocols thereto to supersede the draft Convention, the aviation working group noted the following disadvantages:

"(1) Many national legal systems, which include aircraft-specific legislation, currently contain assignment rules that are more in line with aircraft financing practices than those proposed in the [draft] Convention. There is no need to disrupt such national legal systems that work well for aircraft financing unless the resulting changes are specifically designed with aircraft financing requirements in mind.

"(2) As the [preliminary draft Convention] may be adopted subsequently, unsatisfactory rules may be applicable to transactions entered into in the interim. That being the case, the finalization and ratification processes relating to the [draft] Convention may be complicated/delayed by virtue of aviation-related objections and/or the need for further national and international consultations.

"(3) The suggested approach raises rather than resolves potential problems associated with sphere and temporal applications of the two instruments. Commercial predictability will decrease, resulting in increased transaction costs.

"(4) Such an approach would not address the potential conflict between the [draft] Convention and the Geneva Convention [on the International Recognition of Rights in Aircraft]."

In this connection, it is worth noting that the preliminary draft Convention/preliminary draft Aircraft Protocol contain detailed provisions dealing with the coordination between the last two texts and the Geneva Convention. The first three disadvantages would be equally true for railway rolling stock and space property.

Should the Commission not feel able to accede to the Unidroit secretariat's preferred solution, set forth above, for an exclusion from the sphere of application of the draft Convention of the assignment of receivables to the extent that these become associated rights in connection with the

financing of all those categories of mobile equipment encompassed by the preliminary draft Convention, the Unidroit secretariat would propose that it nevertheless accede to the clear desire expressed by the aviation, rail and space working groups for an exclusion of the assignment of receivables to the extent that these become associated rights in connection with the financing of those categories of aircraft equipment, railway rolling stock and space property encompassed by the future Unidroit Convention as implemented by Protocols thereto.

A/CN.9/472/Add.2

Compilation of comments by Governments and international organizations

ADDENDUM

CONTENTS

STATES

Ireland

[Original: English]

Ireland will, as suggested by the Secretary General of the United Nations, confine itself largely to those matters specified in the note of 29 November 1999.

Title and preamble

As regards the title, Ireland has no very strong preference. On the whole, Ireland believes the words in the second set of square brackets "of receivables in international trade" are preferable. As regards the preamble, we would regard it as generally satisfactory. In the second and fifth indents, the words in square brackets can be retained. The third indent, however, seems excessively long and cumbersome. Much in the language in square brackets should be dropped. We propose the wording "desiring to establish principles and to adopt rules relating to assignment of receivables that would create certainty and transparency and promote modernization of law relating to assignment of receivables while protecting existing practices and facilitating the development of new practices". The remaining language in the draft text is largely superfluous.

Conflict of laws (chapter V)

Ireland is of the view that chapter V should be omitted.

Exclusion or special treatment of certain practices (articles 4 and 5)

The proposal to limit the definition of receivable so as to exclude certain practices is a matter of difficulty. The view Ireland took at the last meeting of the Working Group was that, in view of misgivings expressed to us by the Irish Banking Federation, we would prefer to narrow the definition if possible. For that reason, Ireland strongly favours the proposal to give special treatment to receivables which are not trade receivables (see A/CN.9/466, paragraphs 71-77). As regards deposit accounts Ireland would broadly favour the formula proposed in A/CN.9/466, paragraphs 64 and 65. As regards "swaps" and derivatives, Ireland has no strong preference. As regards aircraft and similar types of mobile equipment, this is a matter of difficulty in view of the draft Unidroit Convention presently being considered. On the whole, Ireland favours a simple exclusionary rule for such receivables.

Definition of "location" (article 6 (i)*)*

The question of "location" has given difficulty. Ireland regretfully finds it impossible to express a preference for any of the alternatives proposed in relation to the location of branch offices.

Annex

The annex is a matter which has given difficulty at successive Working Group sessions. On the whole, Ireland would favour its deletion.

Effects of declarations on acquired rights (article 41 (5))

As regards the effects of a declaration on rights acquired before a declaration becomes effective, Ireland would not favour permitting such a declaration to have retrospective effect.

Romania

[Original: English]

Title and preamble

The title of the draft Convention should be: "Convention on Assignment of Receivables in International Trade". The fifth paragraph of the preamble should read: "Being of the opinion that the adoption of uniform rules governing assignments in receivables would facilitate the development of international trade and promote the availability of capital at more affordable rates."

Definition of "receivables financing" (article 6 (c)*)*

The definition in article 6 *(c)* should read: "'financing through receivables' means financing using any transaction in which value, credit or related services are provided for value in the form of receivables. The financing through receivables includes but is not limited to factoring, forfaiting, securitization, project financing and refinancing."

Conflict of laws

In articles 28 *(l)* and 29, the text within square brackets should be deleted. The rest should remain unchanged.

Application of the annex (article 40)

In article 40, the first set of bracketed language should be deleted. The rest should remain unchanged.

Transitional application of the draft Convention (articles 41 (5), 41 (3) and 43 (3))

The brackets around articles 41 (5), 43 (3) and 44 (3) should be deleted.

Spain

[Original: Spanish]

I. General comments

The Government of Spain wishes to extend its congratulations to the United Nations Commission on International Trade Law (UNCITRAL) on the conclusion of the work of the Working Group on International Contract Practices devoted to the preparation of the draft Convention on Assignment of Receivables in International Trade ("the draft Convention").

These congratulations reflect the general view of the Government with regard to the draft Convention, which it considers to be an appropriate and effective instrument for achieving progress towards a uniform law in the area of the assignment of receivables in international trade. The Government thus regards the draft Convention as having a very high degree of acceptability. The comments are structured in accordance with the note of the UNCITRAL secretariat inviting comments (LA/TL 133 (18) CU 99/247).

II. Specific comments

Title and preamble

The title should include a reference to "international trade" but not to "receivables financing". The term "financing" could give rise to problems of interpretation, since it is not universally understood in the same way. The definition in article 6 *(c)* would not eliminate those problems entirely. Furthermore, including a reference to "financing" might result in creating the impression that the scope of the draft Convention is narrower than it actually is. For the same reasons, the reference to "financing" in the preamble could be deleted. However, in view of the fact that facilitating financing practices is the main objective of the draft Convention, the commentary on the draft Convention should include a list of financing practices to be covered with appropriate explanations. The commentary should, in particular, explain that normally the assignor and the as-

signee would be business persons. Such an explanation would also serve to clarify the meaning of the exclusion in article 4 (1) *(a)*. In conclusion, the title should be as follows: "Draft Convention on Assignment of Receivables in International Trade".

Scope of application of chapter V (article 1 (3))

The purpose of article 1 (3) is to introduce certainty as to the law applicable to assignment-related transactions in an international context in cases where such transactions lie within or outside the scope of application of the draft Convention. For chapter V to apply, a transaction has to have an international element, as defined in article 3, but there is no need for a party to be in a Contracting State. The value of chapter V is that it codifies certain generally accepted principles, such as the principle of party autonomy (article 28) and the principle of debtor protection (article 29), while it addresses certain other matters, such as priority issues (article 30), on which current private international law rules, including article 12 of the Rome Convention, are not very clear.

Spain agrees that chapter V should be applicable to cases where there is some element of internationality, as defined in article 3, even where there is no territorial connection between a party and the draft Convention. In this connection, no serious obstacles can be seen to the introduction of a mini private international law convention, although any potential conflict with the Rome Convention should be avoided. The view that chapter V may usefully supplement the substantive law part of the draft Convention can be also supported. Therefore, article 1 (3) and chapter V should be retained with some minor drafting changes.

Financial receivables (article 5)

The assignment of financial receivables should be treated in some respects differently from the assignment of trade receivables. However, there is no reason to define in the draft Convention either category of receivables. Any definition would fail to capture all practices and would leave out practices to be developed in the future. This is the problem with the definition of "trade receivable" in article 6 *(l)*. In any case, if it is felt necessary to include a definition, this definition should be formulated in broader terms. The following formulation could be considered: "'trade receivable' means any receivable arising under an original contract in respect of goods or services which are not exclusively financial".

Between variants A and B, variant B has the disadvantage that it refers the overall validity of the assignment to private international law. On the other hand, variant A has the advantage that it offers a flexible regime which may better meet the needs of practice. Such flexibility is evident in that the validity of the assignment as between the assignor and the assignee is preserved, while the rights of the debtor are protected, if the debtor needs such a protection. Therefore, variant A should be adopted.

Definition of "location" (article 6 (i)*)*

Subparagraphs (i) and (iv) of article 6 *(i)* do not require any comment (they are standard provisions in UNCITRAL texts). Subparagraph (iii) of article 6 *(i)* establishes a provision which will suffice for the vast majority of cases where the debtor has more than one place of business. In such cases, the place of business of the debtor will be that with the closest relationship to the original contract. However, article 6 *(i)* (iii) may not work as well in the case of a contract for the supply of materials for the debtor's facilities in different countries, if it is not sufficiently clear from the contract which of those locations is the place of business most closely related to the contract. It would, therefore, be advisable to incorporate an additional provision which, in the event that the principal requirement is not fulfilled, offers a way to determine the debtor's location. Furthermore, this provision should apply the same criterion established in the draft Convention to determine where the assignor (or the assignee) is deemed to be located. In order to accommodate this proposal, the following sentence should be added at the end of article 6 *(i)* (iii): "If the place of business of the debtor cannot be determined, the place of business is that place where the debtor's central administration is exercised".

Subparagraph (ii) of article 6 *(i)*, which refers to the place of central administration, offers the advantage of clarity, since the place of central administration is normally a known point of reference in the business world. This rule, therefore, deserves support, although it may require some minor modifications. The rule would be appropriate for multinational corporations operating through subsidiaries, since each subsidiary should be treated as a separate entity even if instructions come from the parent company. However, treating branch offices as separate entities, as suggested (see A/CN.9/466, para. 99), may not be appropriate. Referring to the place of the branch, in whose books a receivable appears prior to the assignment, presents the problem of lack of transparency, since, in view of confidentiality requirements, it may not be evident to third parties where a receivable is booked. In addition, in the case of multinational corporations, there is nothing to prevent a transaction, which is being conducted and arranged in one country, from becoming directly entered on the books of the parent company and vice versa. There is certainly nothing to prevent the contract from containing an agreement regarding the place in which such entries should be made. However, such an agreement is equivalent to one in which the assignor and the assignee determine where the transaction is deemed to have been performed and, thus, determine whether the draft Convention applies or not. Such an approach would run counter to the regime envisaged in the draft Convention which does not permit parties to affect with their agreement the rights and obligations of third parties (article 7). The reason for the approach in article 7 is the need for certainty with regard to the law applicable to rights of third parties. In view of the above, a separate rule for branch offices should be avoided.

Relationship with other international texts (article 36)

The main question arising in this connection is the relationship between the draft Convention and the preliminary draft Convention and protocols being prepared by Unidroit and other organizations. Those preliminary texts, in their current formulation, are intended to address a number of assignment-related issues, including validity of the assign-

ment, enforceability as against the debtor and priority based on registration.

Article 36 adopts an approach taken in other UNCITRAL texts (e.g. article 90 of the United Nations Sales Convention), giving precedence to other international agreements, without making a particular reference to any agreement. Bearing in mind the more general character of the UNCITRAL draft Convention and the fact that, in all probability, the UNCITRAL draft Convention will be adopted before the Unidroit instruments, the Unidroit instruments should be left to establish their own limits. The UNCITRAL draft Convention does not need to explicitly deal with a hypothetical, future and uncertain conflict. There is an additional reason to take this position. While, assuming that both instruments are in force and apply to the same situation, conflicts could arise, arrangements for the financing of high-value mobile equipment (satellites, aircraft, etc.) tend to be subject to a separate regime. It is, therefore, difficult in practice to conceive of a situation in which the two regimes might apply simultaneously to a single assignment transaction. Therefore, article 36 should be retained as is.

Articles 35 to 39

Articles 35 to 39 refer to a "State" making a declaration. In all those articles, reference should be made to a "Contracting State". In the absence of such a reference, for example, article 37 would appear imposing a special regime (e.g. that of chapter V) on those non-Contracting States that did not make a declaration (e.g. under article 37).

Application of the annex (article 40)

The second set of bracketed language in article 40 would be preferable. It seems to give more flexibility to States than the first set of bracketed language and it better clarifies the options of States and the effects of each declaration. Furthermore, it clearly sets out what is sought by the annex as a whole and by each of its sections. The annex is useful in that it provides States an option between two sets of substantive law priority rules. The annex also usefully supplements the private international law provisions of the draft Convention that refer priority issues to the law of the assignor's location. If the State of the assignor's location opts into one of the two sets of priority rules contained in the annex, those rules would govern the priority conflicts set forth in articles 24 and 26.

With regard to the registration system foreseen in the annex, it could be noted that it is viewed today with justifiable scepticism, mainly because it may affect fundamental aspects of national law. However, with the increase in the volume and the further development of electronic communications, it may become more acceptable in the future. For this reason, although our legal system does not coincide with the registration-based system envisaged in the annex, we feel that it is preferable to retain it. In conclusion, only the second set of bracketed language should be retained in article 40 and the annex should be retained as is.

Effects of declarations and transitional application issues (article 41)

Paragraphs (1) to (4) of article 41 reproduce provisions of other UNCITRAL texts (e.g. article 97 of the United Nations Sales Convention and article 26 of the United Nations Convention on Independent Guarantees and Standby Letters of Credit). There is no reason for departing from the approach adopted in those two Conventions. Paragraph (5), aimed at protecting rights acquired before a declaration or its withdrawal take effect, is a new provision. Its rationale, however, is not new. It underlies paragraphs (3) and (4), which provide for a period of six months between the date a declaration or its withdrawal is made and the date it takes effect.

It should be noted that declarations may be made with respect to key questions, such as the application of the draft Convention to territorial units of a federal State (article 35), the applicability of chapter V, the function of articles 11 and 12 of the draft Convention in the case of a sovereign debtor (article 38), the possibility of excluding specific practices listed in the declaration (article 39) and the application of the annex (article 40). Such declarations by States extend beyond the strictly public sphere of Government and have a direct effect on assignors, assignees, debtors and other third parties. Respect for the citizens of a State and, in particular of a State other than the State making the declaration, dictates the need for the safeguards adopted in article 41 (5). If a different position were to be taken, certainty as to the rights of parties under the application of the draft Convention would be severely compromised. Therefore, article 41 should be retained as is.

United Arab Emirates

[Original: Arabic]

I. General comments

Overall, we do not see any conflict between the draft Convention and the laws in force in our State (we have not received the comments of all competent bodies and may forward any further comments as soon as we receive them). However, in the Arabic text of the draft Convention, the meaning of a number of articles is obscure. This is due to the use of incomprehensible terms (such as the Arabic term for "factoring" in article 6 *(c)*) or to the structure of certain provisions (e.g. articles 19 (6), 20 (3) and 22 *(l)*).

II. Specific comments

Title

The title should be: "Draft Convention on Assignment of Receivables in International Trade" (with a change in the Arabic word for "assignment").

Law applicable to the relationship between the assignor and the assignee (article 28)

We are of the opinion that the principle established by article 28 that the law applicable to the rights and obligations of the assignor and the assignee in the absence of [their] choice of a law is "the law of the State with which the contract of assignment is most closely related" is not sufficiently specific. Nevertheless, we note that article 37 permits a State to declare at any time that it will not be bound by chapter V.

Treatment of receivables other than trade receivables (article 5)

The text of variant A contains numerous references to other subsequent articles, which in turn refer to some other articles. This results in a fragmentation of the substantive integrity of the provisions of the draft Convention and in obscuring their meaning. The same comment is applicable to many of the articles of the draft Convention. We propose that variant B be adopted, as it addresses the same provisions with fewer references and is therefore clearer.

INTERNATIONAL ORGANIZATIONS

Factors Chain International

[Original: English]

I. General comments

The Factors Chain International ("FCI") commends the UNCITRAL Working Group on International Contract Practices for the work achieved so far. The draft Convention on Assignment of Receivables ("the draft Convention") constitutes a balanced text which should facilitate, inter alia, factoring transactions. For this reason, FCI supports the work of UNCITRAL on this topic. As to the issues that remain pending, we would note the following.

II. Specific comments

Title

The following title of the draft Convention would seem to provide the clearest indication of its contents: "Draft Convention on Assignment of Receivables in International Commerce". If this were to be adopted, the definition of "Receivables financing" in article 6 *(c)* should be omitted.

Scope of chapter V (article 1 (3))

We have no comment on the proposal to retain article 1 (3) which is at present in square brackets because we have in the past recommended the deletion of chapter V except for article 29 which should be moved to section II of chapter IV.

Assignments of receivables other than trade receivables (article 5)

As regards the exclusion of certain banking practices from some provisions of the draft Convention, we believe that the best way forward is the suggestion contained in A/CN. 9/466, para. 71 so that receivables other than trade receivables may be dealt with separately from trade receivables.

Definition of "location" (article 6 (i)*)*

We have expressed serious reservations regarding the use of the place of central administration to define the location of an assignor with more than one place of business. We consider that for some small- and medium-sized enterprises that place may be difficult to determine. In spite of that reservation, in the absence of a more certain definition acceptable to the majority of the Working Group we would support a definition on the lines of article 6 *(i)* (A/CN.9/466, annex I). However, we consider it more logical that subparagraph (ii) of article 6 *(i)* should be as follows: "if the assignor has a place of business in more than one State, the place of business is that place where the central administration is exercised". We do not see why the assignee should have to try to determine where the central administration of the assignor is exercised when the assignor has more than one place of business but all are in one State so that there is no doubt how subparagraph *(i)* will apply.

Conflicts with other international texts (article 36)

As regards the possible conflict with the proposed Unidroit draft Convention on mobile equipment, we understand that no provision would be made in the draft Convention so that the normal principles of treaty law would provide for the more specific and later Convention (i.e. Unidroit) to prevail.

Annex

We see no reason for the annex as it stands at present. Both regimes for the determination of priorities are less acceptable to us than that which gives priority to the assignee whose assignment is first notified to the debtor; that rule has worked generally in a satisfactory manner in all those jurisdictions in which the law is based on English law.

Registration may be a better system but it is unlikely to be adopted by some of the important trading States. Priority for the first assignment in time may have most unsatisfactory results for those who provide trade credit. If the annex is to be retained, then a third choice should be included.

A/CN9/472/Add.3

Compilation of comments by Governments and international organizations

ADDENDUM

CONTENTS

STATES

Japan

[Original: English]

Japan believes that the unification of laws concerning assignment of receivables is important from the point of view that it would prevent complications arising out of differences of laws of various countries and promote international receivable financing. We are continuing a careful study of the draft Convention with special attention to pending issues, including the issues of location (article 6 *(l)*), receivables other than trade receivables (article 5) and individual provisions concerning private international law. At this point, we would like to make brief comments on the issues as follows.

Title and preamble

Japan is of the view that it is preferable that the words "receivables financing" remain in the title and the preamble, because the draft Convention contains rather detailed provisions as to obligations or defences (chapter IV, sections I and II), which might not be always suitable for all kinds of assignment of receivables.

Scope of chapter V (articles 1 (3) and 37)

With a view to improving uniformity in the field of assignment law, it is preferable that the substantive priority rules in the annex do not apply through the private international law rules in chapter V. Therefore, Japan is of the opinion that article 1 (3) should be deleted and chapter V should have a provision stipulating explicitly that the chapter only supplements the draft Convention.

We prefer this chapter to be subject to an opt-in rather than to an opt-out clause (article 37 should be amended), because we understand that it is aimed at States that do not have such private international law rules.

Debtor's discharge by payment (article 19)

We would like to clarify article 19 (5), in particular with regard to the case in which A assigns a receivable to B, who assigns it to C subsequently, and the debtor requests C to provide adequate proof of the assignment.

One question is whether C needs to provide proof concerning the assignment only between B and C, or proof concerning both assignments so that C might be a true assignee. We believe that the latter might be proper considering that the debtor would not necessarily be notified of the assignment between A and B provided that article 18 (3) which states that notification of a subsequent assignment (in this case, between B and C) constitutes notification of any prior assignment (between A and B).

Another question is, if C fails to provide adequate proof of assignments, whether the debtor should pay A or B in order to be discharged.

United States of America

[Original: English]

I. General comments

The report of the 31st session of the Working Group (A/CN.9/466) and the consolidated text of the draft Convention, set out in annex I thereto, provide a well-negotiated basis on which to conclude a final international text of a United Nations convention on modern commercial finance law relating to the assignment of receivables ("the draft Convention"). The benefits of global economics and trade have not yet been fully realized in many States, and the absence of adequate international commercial finance and credit in this important area is one of the obstacles for achievement of these goals. The draft Convention can substantially cover that gap and thus benefit countries at all levels of economic development and in all regions.

Bulk assignments and assignments of future interests

The development of modern commercial finance law relating to the assignment of receivables through the draft Convention and the ability to generate credit from capital markets through such laws offer an important opportunity to address these goals. A multilateral convention can achieve these ends by recognizing the validity of and supporting the use of assignments of receivables, especially for future interests and large volume assignments, which have become the backbone of new sources of credit in international capital markets.

Commercial predictability as key to generating credits

In addition to including substantive uniform rules for the assignment of receivables, the draft Convention provides States with options in order to adapt the draft Convention's provisions to their particular economic needs. On some other matters the draft Convention sets out rules to determine which national legal regime applies, which can also promote finance, provided that the rules reflect transactional practice, serve the needs of commercial efficiency and are not counterproductively premised on general notions of conflict of laws. The combination of these techniques in the draft Convention is aimed at assuring the necessary level of commercial certainty, which is critical to the willingness of capital markets to extend credit to areas previously under-served.

II. Specific comments on key issues

Scope of application (article 1)

The draft Convention's standards on location of the assignor, the assignee and the debtor, and consistency of those standards with the equally important standards in articles 24 and 25, are critical to achieve benefits under the draft Convention. Financing parties in modern assignment practices must have ex-ante certainty of when the draft Convention applies, and cannot be left generally to a later analysis of facts and circumstances, or the benefits of the draft Convention will be lost. This is especially the case with the major source of new credits through assignments which involve future interests, and bulk and syndicated assignments.

Article l (1) *(b)* needs to be aligned with article l (1) *(a)* so as to require for a subsequent assignment, like article l (1) *(a)* does for an initial assignment, that the assignor be located in a Contracting State. The rationale for the requirement in article l (1) *(a)* that the assignor be located in a Contracting State was that the rules of the draft Convention, especially those relating to third-party rights in part III of chapter IV, must apply to all third parties dealing with the assignor. This application could not be assured, particularly in the likely case of a dispute with a third party arising in a forum in the assignor's State, unless the assignor's State were a Contracting State. We see no policy reason to distinguish between initial assignments and subsequent assignments in requiring the assignor to be located in a Contracting State. We believe that the Working Group did not intend for there to be different treatment.

To align article 1 (1) *(b)* with article 1 (1) *(a)*, we suggest that article 1 (1) *(b)* should read as follows:

> "*(b)* a subsequent assignment by an assignor located in a Contracting State at the time of the conclusion of the contract of assignment, provided that any prior assignment is governed by this Convention; and"

The assignment addressed in article 1 (1) *(c)* is not really a third type of assignment to which the draft Convention applies, as is suggested by the present wording, but rather this provision is a negation of a possible limitation that might otherwise have been made with respect to a type of assignment described in article 1 (1) *(a)*. Therefore, this provision should be modified to be a new paragraph (2), reading as follows:

> "This Convention applies to a subsequent assignment that is described in paragraph (1) *(a)* of this article notwithstanding that this Convention did not apply to any prior assignment of the same receivable."

Scope of application (article 2 (a)*)*

Article 2 *(a)* is in many ways a scope provision. This is because the definition of the term "receivable" in article 2 *(a)*—any contractual right to the payment of a monetary sum—is so broad that the draft Convention must address as a matter of scope, either by a rule in the draft Convention or by exclusion, a wide variety of financial practices that may involve the assignment or possible assignment of a receivable as so defined. The rules of the draft Convention generally work well, and are generally consistent with current commercial practices in many countries, when the receivable is a contractual right to payment arising out of the sale of goods or the provision of personal services.

The draft Convention does not work as easily in the case of other receivables, such as those arising out of deposit accounts, securities accounts, commodity accounts, swaps and other derivatives, repos, letters of credit, independent

guaranties and the leasing of real estate. To increase the opportunity of the draft Convention to gain broad acceptance, certain rules may possibly need to be adjusted, or specific exclusions provided, for those cases. It would be our hope that this goal could be achieved at the Commission meeting in June 2000.

Excluded transactions (articles 4 and 5)

We continue to believe that proposals for exclusion of certain transactions or entities or negotiation of special provisions to accommodate those sectors, raised at the previous meeting of the Working Group, remain an important cross-cutting issue. Our proposal with respect to certain commercial sectors set forth at the last meeting of the Working Group in variant A of article 5 has been subsumed in our comments on article 2 *(a)* above. We continue our efforts to confer with industry groups to seek the appropriate solutions in this area.

"Location" (article 6 (i)*)*

We are continuing to consult with industry groups in various countries and governmental regulatory authorities as to whether the rules for determining the location of an assignor in article 6 *(i)* should be modified for branches of banks. It is important to consider whether the location rule should take into account the common practice of banks to expand their foreign operations through branch banking. The separate regulatory scheme that many States have devised for branches of foreign banks operating in their States, and current debt syndication and trading markets in which banks and other parties, in dealing with each other, regard a regulated branch of a foreign bank much like a separate legal entity operating domestically in the State in which the branch is located *(for an initial proposal which the Working Group did not have time to consider, see A/CN.9/466, paras. 98 and 99*). A similar treatment may be desirable for branch offices of foreign insurance companies where like regulatory considerations may be implicated.

Effectiveness and time of assignment (articles 9 and 10)

There are three situations in which these articles might be read to bring about a result different from that intended by the Working Group. First, despite the clear policy choice in article 9 to validate individual or bulk assignments of future receivables, article 24 might be interpreted so as to override the effect of that policy choice. Second, despite the clear policy in article 24 *(a)* (iii) of deference to the insolvency law of the State in which the assignor is located, articles 9 and 10 could be read to override that domestic insolvency law regarding priorities with respect to certain receivables arising after the commencement of the insolvency proceeding or earned after the commencement of the insolvency proceeding by the use of unencumbered assets of the insolvency estate. Third, despite the Working Group's clear intention to have no Convention rule that would override statutory limitations on assignment, article 9 might be interpreted to override an applicable statutory limitation on assignment of a receivable.

We offer a further explanation of our concerns and suggested language in the appendix hereto.

Priority in proceeds (article 26)

The text of article 26 should clarify that the assignee's proceeds interest is not superior to the interest of another assignee in the proceeds themselves if that other assignee's interest in the proceeds (in contrast to its interest in the receivable out of which the proceeds arose) would be superior under the law of the assignor's jurisdiction. To achieve this clarification, we would suggest adding to article 26 the following:

> "(3) Paragraphs (1) and (2) of this article do not affect the priority of the right of another assignee in the proceeds themselves if the other assignee's right in the proceeds would have priority under the law of the State in which the assignor is located."

Reservation as to sovereign debtors (article 38)

Insert "..., or any specified public entities or agencies," after "A State may declare at any time that it ...". Because a complete exclusion would significantly limit the benefits of the Convention, it is important to allow States narrowly to tailor the proposed exclusion, if that is in their economic interest, rather than permit only an "all or nothing" choice of a complete exclusion. In some States, public entities are involved in a broad area of transactions.

Annex (sections I and II)

Transparency, a particularly important factor in modern capital markets, is implemented in some countries through the use of publicly accessible notice filing (registry) systems, which enable any financing party to be on notice of certain prior rights, and which generally establish priorities between certain claimants. This technique has proven to be a significant factor in expanding credit and lowering rates in those countries where it has been employed. The draft Convention appropriately does not require this technique to be adopted, but rather provides in annex I, sections I and II a fully optional approach, which any State can opt into at any time in order to obtain its benefits.

III. Specific comments on other issues

Title

We recommend that the title be "Convention on Assignment of Receivables". The discussions at the Working Group have led us to the view that the term "financing" should be avoided so as to preclude arguments as to scope of application based on which transactions fall within the draft Convention solely because of the differing usages of that term.

Preamble

In order to reflect in the principles embodied by the preamble the purposes of this work as often discussed by the Working Group, we recommend that the language of the third paragraph be restated as follows:

"Desiring to establish principles and adopt rules relating to the assignment of receivables that would create certainty and transparency and promote modernization of law relating to assignments of receivables, including but not limited to assignments used in factoring, forfaiting, securitization, project financing, and refinancing, and that would facilitate the development of new practices without disrupting existing practices,...",

and that the following sentence be substituted for the fifth paragraph:

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

Application of the annex (article 1 (4))

The language should be clarified to reflect the intention of the Working Group that "applies in" refers to the substantive law of the State whose law is being applied, rather than the law of a forum State in which an action may happen to be maintained.

"Location" (article 6 (i) *(ii))*

The commentary should clarify that "place of central administration" means the chief executive office, i.e. place from which the assignor or assignee manages its affairs, and not a place where books and records are kept or where assets are located. It is to be determined with a view to providing maximum certainty and predictability for those dealing with the assignor or assignee under the draft Convention.

Gap-filling (article 8 (2))

The last clause should be amended, or commentary added that clarifies that under this provision, the law applicable as determined by the draft Convention is first applied, and then as necessary the law applicable through general conflicts rules of that jurisdiction.

Effectiveness of assignment (article 9 (2))

In order to carry out the purposes of the article, the phrase "at the time a future receivable arises" should be substituted for "at the time of the conclusion of the original contract", which may have been inadvertently carried over from an earlier draft.

Liability for violation of contractual limitations (articles 11 (2) and 12 (3))

It is important to clarify the effect of the (identical) second sentences of each article, or alternatively restate them. Both provisions provide a rule negating liability in a specified circumstance. It is very important to make clear that: the draft Convention itself does not create or provide a basis for liability of a person not a party to an anti-assignment agreement; the existence vel non of liability of such a person is left to national law; and the purpose, and the sole effect, of these provisions is to negate liability based solely on the ground of knowledge of the agreement, should that be a sufficient ground for liability under the applicable national law.

Security and supporting rights (article 12)

Article 12 refers in four instances to a right "securing" payment. This reference is intended to include personal rights such as a guarantee. Indeed, this is the type of personal right most likely to be the object of this provision. In some States, however, such as the U.S., a guarantee is not a form of security, as it is not a form of right in property; rather, it is, in such systems, a claim properly characterized as a "supporting" obligation. This point can be adequately dealt with by the commentary, making clear the inclusion of such personal rights within the meaning of the article, and, thus, that no change to the text of the draft Convention is required.

Notification of the assignment (article 19 and other appropriate articles)

The term "notification of the assignment" is a defined term and refers to a writing that satisfies certain requirements. As a result of differing interpretations by reviewers, references in the official commentary or a textual mark to indicate a defined term should be used to signal that reference is made to the defined term, and not to a general concept of notification, which could otherwise be misunderstood as meaning simply when the debtor learns of the assignment.

Debtor's discharge (article 19 (2))

Replace "notification of" with "notifications of assignment indicating to the debtor that". In view of the fact that the rule refers to the first notification received, it applies only when the debtor has received more than one notification.

Modification of the original contract (article 22 (3))

The article refers only to modifications agreed between the assignor and the debtor. Thus, there is no way an assignee can incur liability for such conduct. The article should be restated so as to be consistent with that.

Recovery of payments (article 23)

The reference to "and the debtor's rights under article 20" is unclear, and could lead to an erroneous interpretation. Article 23 refers to affirmative recovery while article 20 refers only to defences and rights of set-off. The two provisions are, therefore, incompatible, and the "without prejudice" clause is potentially misleading. The phrase should be deleted. If, however, some reference is nevertheless deemed necessary, an explanation in the commentary would be better. If the text is for some reason deemed necessary, a separate sentence to the following effect would be appropriate: "The debtor's inability to obtain an affirmative recovery under this article does not preclude the debtor's assertion of a defence or set-off in such amount if the debtor is otherwise entitled to do so under article 20."

Priority in proceeds (article 26 (2))

This provision should be revised to make clear that each competitor stands on its own footing. The present wording suggests that an assignee loses to each type of competitor unless it has priority over not only that type but also over all other types. The rewording should make explicit the relevant date for determining whether the condition has been met.

The commentary should make clear that the instructions referred to paragraph (2) *(a)* of article 26 may be given: at any time, whether at the inception of the assignment transaction or at a later time, such as the assignor's default; as part of the contract of assignment or in a separate document; in specific terms or in general language; and in writing, electronically or in any other manner that is capable of proof.

Law applicable to the relationship between the assignor and the assignee (article 28)

Subject to how this chapter finally reads, the bracketed language is important to avoid it being construed as an opening for an override of other provisions of the draft Convention, outside of chapter V, which determine applicable law.

Relationship with other texts (article 36)

If the bracketed language is retained, a separate exclusion may be necessary for those aircraft financing transactions in which the receivables are identified with and bound to particular aircraft or engines, in view of industry practices and special laws applicable to aircraft transactions in some States.

Additional exclusions (article 39)

This provision should be retained in order to permit adjustments necessary for States to implement the draft Convention's terms. Unnecessary use of this provision would adversely affect the credit ratings of parties within any State, so use of this provision is expected to be self-limiting.

Application of the annex (article 40)

In paragraph (1) *(a)*, the term "will" should be replaced by "may", in line with the approach that use of the registration system is optional even for States that choose sections I and II, as indicated in paragraph (1) *(b)*. States may wish to, and would be able to under this formulation, establish their own or use alternative registries. Registries that do not operate efficiently and reliably will not draw credit, so this mechanism while preserving options is also self-correcting.

Transitional application issues (articles 41 (5), 43(3) and 44 (3))

The transition provisions are very important, and need to be further tested as to their effect on common paradigms of receivables practice. Commercial lenders need certainty that prior rights will be unaffected, and certainty as to at what point of time new transactions are covered by the draft Convention.

Registration-based priority provisions (annex, articles 1 and 2)

This section should also be amended so as to permit States to provide by declaration further adjustments to articles 1 and 2 as to the manner in which such a notice-filing system is effected as to them.

Establishment of registry (annex, article 3)

We are prepared to work informally at the Commission session or at any subsequent time with other States that are considering joining the new registration regime, in order to prepare the groundwork for internationally-linked notice-filing systems. We would at the same time oppose any provision which would unnecessarily raise costs of and make setting up such system(s) much more difficult, by requiring a diplomatic or other process unsuited to establishing a technical computer-based system. The experience of other international bodies is instructive in this regard. The preliminary draft Unidroit Convention, which will have as an integral part of its structure such a computer-based notice system, will include some brief guidelines, but will leave the establishment of the system to the Contracting States after the preliminary draft Unidroit Convention is adopted. Further, as noted in comments to article 40 above, participation in any registry system is wholly optional, and would permit any State to substitute its own registry system, should it so choose.

Appendix

Explanation of comments on articles 9 and 10

Bulk and future assignments. Article 24 might be interpreted to override article 9's validation of bulk and future assignments. This could occur in cases in which the domestic law of the State in which the assignor is located does not recognize such an assignment and, thus, would find the assignment ineffective as against the claim of a competing party or would subordinate the rights of the assignee as against such a party. In those cases, the reference in article 24 to the law of the assignor's State to resolve competing rights of other parties might lead a court to apply that domestic law to reach the conclusion that the assignee of the future receivables has no rights with respect to such parties or is subordinate to them.

To avoid this possible interpretation, we suggest that article 9 be amended by adding the following language:

> "(3) A transfer of a receivable is effective, as between the assignor and the assignee, at the time of transfer.
>
> (4) A transfer of a receivable is not ineffective against and may not be subordinated to, a person described in paragraph (1) *(a) (i)* to (iii) of article 24, solely because law other than this Convention does not generally recognize an assignment described in paragraph (1) or (2)."

The Commentary could make clear that the word "generally" in proposed paragraph (4) is intended to refer to the general provisions of the commercial law of the assignor's country that does not recognize bulk assignments or assignments (whether individual or in bulk) of future receivables, and that the word "generally" is not intended to refer to more specific laws of the assignor's country that, for manifest policy reasons, prohibit the

assignments of certain more narrow types or categories of receivables. For example, law prohibiting assignments of future wage receivables as a specific category of receivables would not be law that "generally" does not recognize present assignments of future receivables, because the law relates to only a specific type of category of receivables, not to receivables generically.

Domestic insolvency law on priorities for post-insolvency receivables. Articles 9 and 10 could be read to override the domestic insolvency law of the assignor's jurisdiction regarding priorities with respect to receivables arising after the commencement of the insolvency proceeding or earned after the commencement of the insolvency proceeding by the use of unencumbered assets of the insolvency estate. This interpretation could result from applying article 24's deference to matters settled elsewhere in the draft Convention to reach the conclusion that the time-of-transfer rules of article 10 override domestic insolvency laws addressing post-insolvency receivables. We do not believe that this interpretation was the intention of the Working Group. Rather, we believe that the intention of the Working Group, as generally indicated in article 24, was to defer to national insolvency law on the question of to what extent an assigned receivable arising after the commencement of the insolvency proceeding, or earned after the commencement of the insolvency proceeding by the use of unencumbered assets of the insolvency estate, could be set aside by or be subject to the interest of the insolvency administrator.

To avoid this interpretation, we suggest that article 9 be amended by adding the following language:

(_) Whether the transfer of a receivable affects the rights of a person described in paragraph (1) *(a) (i)* to (iii) of article 24 is determined in accordance with section III of chapter IV.

Statutory prohibitions on assignment. Article 9 might be interpreted to abrogate an applicable statute that limits assignment of a receivable by contract. This is because article 9 appears to render *all* contractual assignments "effective".

Addition of the following language to article 9 would preserve applicable statutory prohibitions on assignment without affecting the provisions of articles 11 and 12 addressing contractual prohibitions on assignments:

(_) This article is subject to any applicable statute that prohibits or limits the assignment of a receivable for a reason other than the existence of a contractual prohibition or limitation of such assignment.

Consolidated text. We offer the following language as a way to interrelate all three of our text suggestions with one another. The language accomplishing the interrelation is in italics.

Article 9. *Effectiveness of bulk assignments, assignments of future receivables, and partial assignments*

(3) A transfer of a receivable is effective, as between the assignor and the assignee, at the time of transfer.

(4) A transfer of a receivable is not ineffective against, and may not be subordinated to, a person described in paragraph (1) *(a)* (i) to (iii) of article 24, solely because law other than this Convention does not generally recognize an assignment described in paragraph (1) or (2).

(5) This article is subject to any applicable statute, other than a statute of the type described in paragraph (4), that prohibits or limits the assignment of a receivable for a reason other than the existence of a contractual prohibition or limitation of such assignment.

(6) *Except as otherwise provided in this article*, whether the transfer of a receivable affects the rights of a person described in paragraph (1) *(a)* (i) to (iii) of article 24 is determined in accordance with section III of chapter IV.

The italicized language is necessary to except *(a)* from the clause preserving any statutory prohibitions on assignment, a statute that generally prohibits individual or bulk assignments of future receivables, *(b)* from the clause requiring priority to be determined under section III of chapter IV, any law that, for purposes of priority, does not generally recognize individual or bulk assignments of future receivables, and *(c)* from the clause requiring priority to be determined under section III of chapter IV, the effect of any applicable statute that does not permit the assignment by contract of a specific type or category of receivable.

INTERNATIONAL ORGANIZATIONS

International Swaps and Derivatives Association (ISDA)

[Original: English]

ISDA (International Swaps and Derivatives Association, Inc.)[1] and TBMA (The Bond Market Association)[2] give their support to the arguments set out in the comments of the EBF (European Banking Federation) and the FMLG (Financial Markets Lawyers Group).[3] ISDA and TBMA join the EBF and the FMLG in supporting the aims of the draft Convention. We are concerned, however, about the impact of certain aspects of the draft Convention on certain financial transactions and the contractual provisions underlying those transactions. These concerns are addressed in detail in the comments of the EBF. We support the proposals made by the EBF, with the additional point that we believe it would be appropriate to further narrow the definition of "trade receivable" in article 5, variant B of the EBF's proposed changes to exclude regular securities accounts, such as margin accounts, and debt securities generally.

[1]ISDA is a global trade association representing more than 450 participants in the privately negotiated derivatives industry, a business which includes swaps, futures and options and combinations of these products relating to a variety of underlying financial and other risks, including interest rates and currency risks. A report of the Bank for International Settlements estimated the total outstanding notional value of four main categories of derivative transaction as at end December 1998 to be US$ 80 trillion and that these transactions had a gross market value at that time of US$ 3.2 trillion. For further information, see ISDA's website (*www.isda.org*).

[2]TBMA represents securities firms and banks that underwrite, distribute and trade fixed income securities domestically and internationally. These debt securities and related investments include: Repurchase agreements; U.S. Treasury securities; Federal Agency securities; Mortgage and other asset-backed securities, Corporate Debt securities; Municipal bonds; and Money Market instruments. Further information concerning the Association may be obtained from TBMA's website (*www.bondmarkets.com*).

[3]See A/CN.9/472/Add.1.

The purpose of the draft Convention is to lower costs of borrowing and increase access to credit by reducing legal risks. It is important, however, that this goal be accomplished without adversely affecting existing, widely accepted contractual arrangements for certain categories of financial transactions, such as derivatives, repurchase agreements and securities lending arrangements. These transactions are a vital risk reduction tool for financial institutions, companies, governmental entities and other users. These transactions are most often documented under agreements sponsored or co-sponsored by ISDA or the TBMA. These agreements establish a means by which exposures under transactions are effectively netted on close-out. Anything that runs the risk of undermining the enforceability of netting under these agreements is a source of concern to ISDA, TBMA and our members.

ISDA and TBMA are grateful for the opportunity to comment on the draft Convention and are willing to assist UNCITRAL by commenting on any specific provisions as and when drafting is proposed by UNCITRAL.

A/CN.9/472/Add.4

Compilation of comments by Governments and international organizations

ADDENDUM

CONTENTS

STATES

Singapore

[Original: English]

I. General comments

As a developing country, Singapore strongly supports the preparation of this draft Convention which is designed to increase the availability of credit at lower cost. The availability of credit is often a critical factor in the development strategies of developing countries. Any initiative to enhance this is therefore to be welcomed. Singapore also notes and strongly supports the underlying principles of this draft Convention, viz. the requirements of internationality, the respect for party autonomy and the strong concerns over consumer and debtor protection. Fundamental to the proposals contained in the draft Convention is the principle that it should not adversely affect existing modalities of doing business and, especially, existing banking and financial practices. The draft Convention is designed to facilitate international trade, generate prosperity and improve the lives of people of the nations of the world in a manner consistent with international law. This principle should always be maintained.

II. Specific comments

Title

As the proposals contained in the draft Convention have now gone beyond merely addressing the assignments of receivables for the purpose of obtaining financing, the original title is no longer relevant. However, the draft Convention very clearly is now designed to address issues arising from assignment of receivables which arise from trading activities, and not all receivables. As such, the title "Convention on Assignment of Receivables in International Trade" is to be preferred.

Non-contractual receivables (article 2 (a)*)*

Singapore would prefer to limit the scope of the draft Convention to contractual receivables. If the draft Convention is to extend to non-contractual receivables, then those other types of receivables should be carefully defined.

They should not, under any circumstances, include tort receivables. To do so would be to encourage litigation and contravene the public policy of countries who are opposed to excessive litigation.

Limitations on assignment of receivables other than trade receivables (article 5)

It has become clear that various articles in the draft Convention would adversely affect established transactions in the banking and financial sectors. These provisions may also be inconsistent with other United Nations Conventions. There is, therefore, an imperative that these established practices be either excluded totally from the ambit of the proposed draft Convention, or that it be carefully prescribed that certain terms of the draft Convention would not apply to them.

Of particular concern are articles 11 and 12. These articles affect a number of established practices in the banking and financial sectors. They would, for example, affect severely the established practice of "netting" in financial transactions. Singapore, therefore, prefers that transactions which may be adversely affected by the proposed draft Convention be excluded from its operation. In this regard, if a choice is to be made based on wording proposed by the Working Group. Variant B of the proposed article 5 would, with appropriate modifications, be preferred over variant A.

"Location" (article 6 (i)*)*

It is of crucial importance that the location of a person be determined with certainty as location determines the applicable law. Failure to determine "location" with certainty undermines the draft Convention, since the entire purpose of the draft Convention, which is to enable certainty in the legal regime governing assignments of receivables, will be defeated. Singapore's clear preference would be for "location" to be determined by objective factors such as place of registration/incorporation, or place where the head office (if any) of a business is located. It is noted that many jurisdictions have established rules for the determining of "location" of a business entity and that it is not desirable to have different rules applicable for different purposes. The solution, therefore, is to attempt to arrive at a formulation which would enable the "location" of a party to be determined by the most objective and transparent factors which can be agreed upon. In this context, it is to be noted that even a concept such as "place of central administration" can often require subjective determination.

Special consideration must be attached to the "location" of branches of banks (including branches of financial institutions who do not qualify under the strict legal definition of "bank"). It is noteworthy that in many jurisdictions foreign banks can operate either as branches, in which case they operate under the same legal personality as the head office, or as separate legal entities incorporated under the law of that jurisdiction. Consideration should be given to whether these should be treated in a similar manner as regards the issue of their "location". The principle to be adopted in determining the "location" of these entities must be one which would not compromise existing realities in the commercial marketplace.

Public policy and preferential rights (article 25)

The phrase "*only if that provision is manifestly contrary*" in article 25 (1) is unclear and may be interpreted differently in different jurisdictions. This would lead to the draft Convention having different degrees of application in different forum States. Singapore prefers that this phrase be deleted and substituted with the phrase "... if that provision is contrary ...".

With regard to article 25 (2), States should be left with the option of depositing a declaration identifying preferential rights. To require States to make such a declaration would, for some States, empower the public officials who are responsible for formulating and filing the declaration to, in effect, make a judicial determination as to what the order of priorities is for that jurisdiction. This may be notwithstanding that the order of conflicting "super-priorities" may not as yet have been judicially determined by the Courts of that jurisdiction. Conferring such powers on public officials would be contrary to the governmental structure for that jurisdiction.

Proceeds (article 26)

In line with the principle that the rules in the draft Convention should not adversely affect existing practices, it should be clearly provided that the rule in this article would not affect the rights of another person in proceeds of the assigned receivable under the law of the assignor's location. In addition to this, to avoid unnecessary complexity and confusion, it should be made clear that this article applies only to cash proceeds and not proceeds in other forms.

Application of chapter V (article 37)

Given that chapter V sets out principles, some of which are not recognized in all legal systems, it is preferable that States be given the choice to opt in rather than have to opt out of the application of this chapter.

Limitation to Government and other public entities (article 38)

This is an important provision for many Governments. The term "*... public entities ...*" is unclear and can be a source of uncertainty. It is not clear, for example, whether this would include State trading agencies which are separately incorporated, or government-linked companies. To address this, it is suggested that States be given an option to identify their "*public entities*" by filing declarations with the depositary.

Effect of denunciation (article 44 (3))

The proposals in our draft are, in practice, modest in effect. Article 44 (3) binds a State to the terms of the draft Convention even after it has denounced it. In the same way as a State can voluntarily bind itself to the terms of a multilateral convention, it should be able to free itself of the obligations created by such a convention when it feels constrained to do so. A restriction on this principle would render the draft Convention less attractive to States who subscribe strongly to it.

The commercial utility of a provision such as article 44 (3) in the scheme established by the proposed draft Convention cannot be disputed. To maintain the effectiveness of the draft Convention and also to enhance its attractiveness, an appropriate modality would be for this article to provide that a State may declare that, notwithstanding its denunciation of the draft Convention, the terms of the draft Convention shall continue to apply to transactions entered into when that State was a Contracting State.

INTERNATIONAL ORGANIZATIONS

Secretariat of the International Institute for the Unification of Private Law (Unidroit)

(Additional comments)

Further to the comments regarding the relationship between the preliminary draft Unidroit Convention on International Interests in Mobile Equipment and the preliminary draft Protocols thereto, on the one hand, and the aforementioned draft UNCITRAL Convention, on the other hand, that it submitted on 14 February 2000 (published in A/CN.9/472/Add.1), the Unidroit secretariat wishes to inform the Commission of the significant efforts made by the Third Joint Session of the Unidroit Committee of governmental experts for the preparation of a draft Convention on International Interests in Mobile Equipment and a draft Protocol thereto on Matters specific to Aircraft Equipment, and of the Sub-Committee of the ICAO Legal Committee on the study of international interests in mobile equipment (aircraft equipment), held in Rome from 20 to 31 March 2000, with a view to meeting the concerns expressed on that occasion by the representative of UNCITRAL, in particular as reflected in the comments submitted by that Organization (Unidroit CGE/Int.Int./3-WP/10 ICAO Ref. LSC/ME/3-WP/10).

First, the substantive sphere of application of the draft Unidroit Convention on International Interests in Mobile Equipment (hereinafter referred to as "the draft Convention") was considerably reduced during the Third Joint Session, essentially with a view clearly to defining the number of categories of equipment requiring exclusion from the sphere of application of the draft UNCITRAL Convention: the only categories of equipment now covered by the draft Convention are airframes, aircraft engines and helicopters, railway rolling stock and space property (cf. article 2 (3) of the draft Convention). The sphere of application of the draft Convention may thus no longer be described as being "open-ended" (cf. § 5 of the UNCITRAL secretariat's aforementioned comments). It is submitted that it should accordingly be that much easier for the Commission to accommodate what the Unidroit secretariat described as its preferred solution when submitting its comments in February, namely the express exclusion from the draft UNCITRAL Convention's sphere of application of the assignment of receivables that become associated rights in connection with the financing of those categories of equipment covered by the draft Convention.

The Unidroit secretariat would moreover take this opportunity to reiterate the importance attached by the Unidroit Aviation, Rail and Space Working Groups to assignments of receivables taken as security in aircraft, rail and space financing transactions being dealt with in equipment-specific instruments, namely the draft Convention as implemented by the relevant draft Protocol, rather than in the draft UNCITRAL Convention.

Secondly, the question of the compatibility of chapter IX of the draft Convention with the rule under certain legal systems that an assignment of associated rights carries with it the interest securing those rights to which the UNCITRAL secretariat had drawn special attention in its comments was also dealt with by the Third Joint Session. A proposal was developed by three delegations containing two alternatives. Time did not permit the Joint Session to complete its consideration of this proposal. It was, therefore, decided to append it as an annex to the text of the draft Convention as reviewed by the Drafting Committee. It is, however, our intention, hopefully in early September 2000, to convene a small working group made up of the Governments and Organizations (in particular UNCITRAL), having expressed particular interest in the question during the Third Joint Session, to complete the work in this respect commenced there. It is submitted that, once this work is completed, the concerns expressed by the UNCITRAL secretariat in this regard will have been satisfactorily dealt with.

III. ELECTRONIC COMMERCE

A. Report of the Working Group on Electronic Commerce on the work of its thirty-fifth session (Vienna, 6-17 September 1999) (A/CN.9/465) [Original: English]

CONTENTS

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 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). 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 no firm decision as to the form and content of such work had been reached, the Working Group had come to the preliminary conclu-

[1] *Official Records of the General Assembly, Fifty-first Session, Supplement No. 17* (A/51/17), paras. 223 and 224.

sion 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 and 157).

3. The Commission 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 UNCITRAL Model Law on Electronic Commerce (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.[2]

5. The Working Group began the preparation of the Uniform Rules at its thirty-second session on the basis of a note prepared by the secretariat (A/CN.9/WG.IV/WP.73).

6. At its thirty-first session (1998), 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 that arose 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 realized so far indicated that the draft Uniform Rules on Electronic Signatures were progressively being shaped into a workable structure.

7. The Commission reaffirmed the decision made at its thirty-first session as to the feasibility of preparing such Uniform Rules 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.[3]

8. At its thirty-second session (1999), the Commission had before it the report of the Working Group on the work of its thirty-third (July 1998) and thirty-fourth (February 1999) sessions (A/CN.9/454 and 457). The Commission expressed its appreciation for the efforts accomplished by the Working Group in its preparation of draft uniform rules on electronic signatures. While it was generally agreed that significant progress had been made at those sessions in the understanding of the legal issues of electronic signatures, it was also felt that the Working Group had been faced with difficulties in the building of a consensus as to the legislative policy on which the Uniform Rules should be based.

9. A view was expressed that the approach currently taken by the Working Group did not sufficiently reflect the business need for flexibility in the use of electronic signatures and other authentication techniques. As currently envisaged by the Working Group, the Uniform Rules placed excessive emphasis on digital signature techniques and, within the sphere of digital signatures, on a specific application involving third-party certification. Accordingly, it was suggested that work on electronic signatures by the Working Group should either be limited to the legal issues of cross-border certification or be postponed altogether until market practices were better established. A related view expressed was that, for the purposes of international trade, most of the legal issues arising from the use of electronic signatures had already been solved in the Model Law. While regulation dealing with certain uses of electronic signatures might be needed outside the scope of commercial law, the Working Group should not become involved in any such regulatory activity.

10. The widely prevailing view was that the Working Group should pursue its task on the basis of its original mandate (see above, para. 3). With respect to the need for uniform rules on electronic signatures, it was explained that, in many countries, guidance from UNCITRAL was expected by governmental and legislative authorities that were in the process of preparing legislation on electronic signature issues, including the establishment of public key infrastructures (PKI) or other projects on closely related matters (see A/CN.9/457, para. 16). As to the decision made by the Working Group to focus on PKI issues and PKI terminology, it was recalled that the interplay of relationships between three distinct types of parties (i.e. key

[2]Ibid., *Fifty-second Session, Supplement No. 17* (A/52/17), paras. 249-251.

[3]Ibid., *Fifty-third Session, Supplement No. 17* (A/53/17), paras. 207-211.

holders, certification authorities and relying parties) corresponded to one possible PKI model, but that other models were conceivable, e.g. where no independent certification authority was involved. One of the main benefits to be drawn from focusing on PKI issues was to facilitate the structuring of the Uniform Rules by reference to three functions (or roles) with respect to key pairs, namely, the key issuer (or subscriber) function, the certification function, and the relying function. It was generally agreed that those three functions were common to all PKI models. It was also agreed that those three functions should be dealt with irrespective of whether they were in fact served by three separate entities or whether two of those functions were served by the same person (e.g. where the certification authority was also a relying party). In addition, it was widely felt that focusing on the functions typical of PKI and not on any specific model might make it easier to develop a fully media-neutral rule at a later stage (ibid., para. 68).

11. After discussion, the Commission reaffirmed its earlier decisions as to the feasibility of preparing such uniform rules (see above, paras. 3 and 5) and expressed its confidence that more progress could be accomplished by the Working Group at its forthcoming sessions.[4]

12. The Working Group on Electronic Commerce, which was composed of all the States members of the Commission, held its thirty-fifth session in Vienna from 6 to 17 September 1999. The session was attended by representatives of the following States members of the Working Group: Australia, Austria, Bulgaria, Cameroon, China, Colombia, Egypt, Finland, France, Germany, Honduras, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Mexico, Nigeria, Romania, Singapore, Spain, Thailand, United Kingdom of Great Britain and Northern Ireland, the United States of America and Uruguay.

13. The session was attended by observers from the following States: Angola, Bahrain, Belgium, Belize, Bolivia, Canada, Costa Rica, Czech Republic, Denmark, Georgia, Guatemala, Indonesia, Iraq, Ireland, Kuwait, Lebanon, Malaysia, Morocco, the Netherlands, New Zealand, Philippines, Poland, Portugal, Republic of Korea, Saudi Arabia, Slovakia, Sweden, Switzerland, Tunisia, Turkey, Ukraine and Yemen.

14. The session was attended by observers from the following international organizations: United Nations Conference on Trade and Development (UNCTAD), United Nations Educational, Scientific and Cultural Organization (UNESCO), African Development Bank, European Commission, Organisation for Economic Cooperation and Development (OECD), Electronic Frontier Foundation Europe, European Law Student Association (ELSA) International, International Association of Ports and Harbors (IAPH), International Bar Association (IBA), International Chamber of Commerce (ICC), Internet Law and Policy Forum (ILPF), and *Union Internationale du Notariat Latin* (UINL).

15. The Working Group elected the following officers:

Chairman: Mr. Jacques GAUTHIER (Canada, elected in his personal capacity)

Rapporteur: Mr. Pinai NANAKORN (Thailand)

16. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.IV/WP.81); a note by the secretariat containing revised draft uniform rules on electronic signatures (A/CN.9/WG.IV/WP.82).

17. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Legal aspects of electronic commerce: draft uniform rules on electronic signatures.
4. Other business.
5. Adoption of the report.

I. DELIBERATIONS AND DECISIONS

18. The Working Group discussed the issue of electronic signatures on the basis of the note prepared by the secretariat (A/CN.9/WG.IV/WP.82). The deliberations and conclusions of the Working Group with respect to those issues are reflected in section II 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.

II. DRAFT UNIFORM RULES ON ELECTRONIC SIGNATURES

A. General remarks

19. At the outset, the Working Group exchanged views on current developments in regulatory issues arising from electronic commerce, including adoption of the Model Law, electronic signatures and public key infrastructure (referred to here as "PKI") issues in the context of digital signatures. These reports, at the governmental, intergovernmental and non-governmental levels, confirmed that addressing electronic commerce legal issues was recognized as essential for the implementation of electronic commerce and removal of barriers to trade. It was reported that a number of countries had introduced recently, or were about to introduce, legislation either adopting the Model Law or addressing related electronic commerce facilitation issues. A number of those legislative proposals also dealt with electronic (or in some cases, specifically digital) signature issues. Other countries had established policy working groups, a number in close association with private sector interests, which were working on the need for legislative change to facilitate electronic commerce, actively considering adoption of the Model Law and preparing necessary legislation, working on electronic signature issues including the establishment of public key infrastructures or other projects on closely related matters.

[4]Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), paras. 308-314.

B. Consideration of draft articles

20. It was recalled that, for lack of sufficient time at its previous session, the Working Group had been unable to discuss the principle of non-discrimination between certificates on the basis of the place at which they were issued (A/CN.9/457, para. 120). For the same reason, the issues of cross-border recognition of certificates had not been considered at previous sessions. Prior to starting with the discussion draft article 1, the Working Group thus decided to engage in an exchange of views with respect to the provisions of draft article 13.

Article 13. *Recognition of foreign certificates and signatures*

21. The text of draft article 13 as considered by the Working Group was as follows:

"(1) In determining whether, or the extent to which, a certificate [signature] is legally effective, no regard shall be had to the place where the certificate [signature] was issued, nor to the State in which the issuer had its place of business.

"*Variant A*

"(2) Certificates issued by a foreign information certifier are recognized as legally equivalent to certificates issued by information certifiers operating under ... *[the law of the enacting State]* if the practices of the foreign information certifiers provide a level of reliability at least equivalent to that required of information certifiers under ... *[the law of the enacting State]*. [Such recognition may be made through a published determination of the State or through bilateral or multilateral agreement between or among the States concerned.]

"(3) Signatures complying with the laws of another State relating to digital or other electronic signatures are recognized as legally equivalent to signatures under ... *[the law of the enacting State]* if the laws of the other State require a level of reliability at least equivalent to that required for such 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.]

"(4) Notwithstanding the preceding paragraph, parties to commercial and other transactions may specify that a particular information certifier, class of information certifier or class of certificates must be used in connection with messages or signatures submitted to them.

"*Variant B*

"(2) Certificates issued by a foreign information certifier are recognized as legally equivalent to certificates issued by information certifiers operating under [*the law of the enacting State*] if the practices of the foreign information certifier provide a level of reliability at least equivalent to that required of information certifiers under ... *[the law of the enacting State]*.

"[(3) The determination of equivalence described in paragraph (2) may be made by a published determination of the State or through bilateral or multilateral agreement with other States.]

"(4) In the determination of equivalence, regard shall be had to the following factors :

(a) financial and human resources, including existence of assets within the jurisdiction;

(b) trustworthiness of hardware and software systems;

(c) procedures for processing of certificates and applications for certificates and retention of records;

(d) availability of information to the [signers][subjects] identified in certificates and to potential relying parties;

(e) regularity and extent of audit by an independent body;

(f) the existence of a declaration by the State, an accreditation body or the certification authority regarding compliance with or existence of the foregoing;

(g) susceptibility to the jurisdiction of courts of the enacting State; and

(h) the degree of discrepancy between the law applicable to the conduct of the certification authority and the law of the enacting State."

General remarks

22. Concern was expressed as to whether draft article 13 was intended to apply to the recognition of both certificates and signatures. One view expressed was that the draft article properly applied to certificates and that any provision dealing with the legal effect of signatures was best placed in the substantive articles dealing with signatures at the beginning of the Uniform Rules. In support of this view, it was stated that it might be difficult to formulate a single rule for the recognition of signatures, given the many different functions of signatures and the differing levels of reliability that might be encountered. It was also pointed out that, while the factors set forth in paragraph (4) of Variant B might properly be considered in respect of certificates, assessing the reliability of signatures within the meaning of Variant A would require the taking into account of different factors. An opposing view was that the draft article should address recognition of both signatures and certificates, since both were important to the question of identification in the context of commercial use and the purpose of the Uniform Rules was the development of rules on the use of electronic signatures, including in cross-border international trade. After discussion, the Working Group decided that the question should be left open until the substantive articles of the Uniform Rules had been considered.

Paragraph (1)

23. While there was general support for the principle of non-discrimination set forth in paragraph (1), doubts were expressed as to whether the provision as currently drafted properly reflected this principle and whether it was appropriate to refer to the country of origin. The view was expressed that reference to the country of origin resulted in a non-discrimination provision that was too narrow, and left open the possibility that discrimination could occur on a

number of other grounds, which would be undesirable. The view was also expressed that, in fact, there might be cases where the country of origin of the signature or certificate was essential to the question of recognition. It was generally felt that the above-mentioned views and concerns should be considered when redrafting paragraph (1) for continuation of the discussion at a future session.

24. It was suggested that the principle of non-discrimination might be expressed more clearly along the following lines:

> "A determination of whether, or the extent to which, a certificate [signature] is legally effective, shall not be based solely on the place where the certificate [signature] was issued, nor solely on the State in which the issuer had its place of business."

That proposal did not receive support.

25. In terms of the relationship of paragraph (1) to Variants A and B, support was expressed for the view that only paragraph (1) was required in order to address the issue of recognition of foreign signatures and certificates. It was stated that the principles reflected in Variants A and B could not be supported as they were too restrictive, too difficult to verify and too generally drafted to provide guidance on how equivalence could be established. It was pointed out that a non-discrimination rule like paragraph (1) would have the effect of encouraging parties to look at the requirements in other jurisdictions where transactions involved foreign signatures and certificates, with a view to ascertaining what evidence might be required for signatures and certificates to be legally effective and to determine what applicable law would be desirable. An opposing view was that a rule on non-discrimination was not sufficient to enable the comparison of different certificates and signatures, which would inevitably be required to facilitate the cross-border use of electronic commerce. For that purpose, a rule on how cross-border recognition could be achieved was necessary. Support was expressed for the view that what was required internationally was guidance on the criteria on which recognition could be based, such as the reliability of certificates and signatures as set forth in Variants A and B. After discussion, the prevailing view was that paragraph (1) was not sufficient for facilitating cross-border recognition of certificates and signatures.

Variant A

26. Support was expressed for the view that Variant A, by referring to reliability, addressed the essential criterion of equivalence upon which recognition could be based. A further view was that reliability should be confined to technical reliability and that requirements such as registration of an information certifier should not be considered. Some concern was expressed, however, as to what such a rule might mean in practice. It was suggested that Variant A could give rise to reverse discrimination, for example if it resulted in a foreign information certifier not having to comply with the law of the recognizing State, provided that its practices were determined to be equivalent, on the basis of specified factors, to the practices of a domestic information certifier. A particular concern in relation to this situation was that the foreign information certifier might gain an advantage over the domestic certifier, specifically where the basis of establishing equivalence did not take into account administrative requirements such as for registration of the information certifier. While these concerns were noted by the Working Group, particularly in view of the agreement on the importance of the principle of non-discrimination, it was generally felt that these concerns could be addressed by setting the factors to be taken into account in determining equivalence. Another concern expressed in relation to the possible introduction of a test of technical reliability (particularly in relation to certificates) was the extent to which reliability of the certificate depended upon the reliability of the information certifier, and thus upon factors not strictly relevant to technical matters.

27. In connection with the possible criterion for establishing equivalence, the view was expressed that the focus in Variant A upon reliability was too narrow and that other factors such as the contractual environment created by the parties were important to a determination of equivalence. It was also pointed out that the provisions of Variant A presupposed a level of regulation of information certifiers and certificates that might not, in practice, be universal and such provisions might prove difficult to implement. The prevailing view in the Working Group was that reliability was an appropriate criterion upon which to make a determination of equivalence for the purposes of recognition of foreign information certifiers, subject to establishing certain factors to be taken into account in making that determination.

28. Wide support was also expressed for recognizing the importance of bilateral and multilateral agreements as a means of agreeing upon recognition, along the lines set forth in paragraphs (2) and (3) of Variant A.

29. There was general support for the inclusion in draft article 13 of a provision establishing ample recognition of party autonomy as a basis for cross-border recognition. It was also agreed that the freedom of the parties to agree on the use of specific certificates or signatures along the lines of paragraph (4) of Variant A should be recognized.

Variant B

30. Various views were expressed as to the need to retain the factors set out in paragraph (4) of Variant B. In support of retaining these factors, it was repeated that a basis for establishing recognition was required and that this paragraph, in combination with paragraph (1) and Variant A, provided such a basis. An opposing view was that it was inappropriate to include, in an article on cross-border recognition of certificates and signatures, requirements in respect of information certifiers not included elsewhere in the draft Uniform Rules. The suggestion was made that if the Uniform Rules were to address the operations of information certifiers and establish factors to which reference should be had in assessing the reliability of certificates issued by such information certifiers, those provisions should be located in substantive articles, such as draft article 12. In addition, it was stated that to include these factors only in provisions addressing recognition of foreign certificates and signatures might lead to discrimination and thus run counter to the principle stated in paragraph (1). Further-

more, some concern was expressed as to the relevance of all of these factors in each case and the need to ensure that the provision was neither drafted as a mandatory provision, nor specifically limited to those factors set forth.

31. With a view to addressing some of the views and concerns that had been expressed in the discussion, a provision on recognition along the following lines was proposed:

"(1) In determining whether, or the extent to which, a certificate is legally effective, no regard shall be had to the place where the certificate was issued, nor to the State in which the issuer had its place of business.

"(2) A determination of whether, or the extent to which, a certificate is legally effective shall be determined by reference to the laws of the recognizing State or such other applicable law as the parties may agree.

"(3) A certificate shall not be held legally ineffective under the laws of the recognizing State or such other applicable law as the parties shall agree solely because a registration requirement under the applicable law has not been met.

"(4) If a recognizing State has entered into a bilateral or multilateral agreement with another State, a certificate issued pursuant to that agreement shall be recognized.

"(5) If the parties agree to be bound by a certificate issued by a specified information certifier that certificate shall be recognized."

32. As doubts were expressed as to how this proposal could be interpreted, particularly in relation to conflicts-of-laws issues, the proposal received limited support.

33. In the context of the discussion as to which of the factors set forth in paragraph (4) of Variant B should be retained, it was pointed out that not all of the factors included might be equally relevant to a determination of reliability or what might be required to prove a certificate. In addition, the view was expressed that the cost and ease of proof of the factors required careful consideration to ensure that they did not act as a barrier to the use of certificates and electronic signatures. The Working Group took note of these views for a discussion of paragraph (4) at a later stage.

34. After discussion, the Working Group concluded that, for the purpose of future discussion: paragraph (1) should state the principle of non-discrimination with some adjustment to the drafting to ensure that the views expressed in the discussion were reflected; paragraphs (2), (3) and (4) of Variant A should be retained as setting out an appropriate rule on recognition of foreign certificates and signatures; paragraph (4) of Variant B should set out the factors to be taken into account in considering equivalence of reliability in relation to paragraphs (2) and (3) of Variant A, but this provision should be neither mandatory nor limited to the particular factors enumerated; draft article 13 should provide for the recognition of agreement between interested parties regarding the use of certain types of electronic signatures or certificates as sufficient grounds for cross-border recognition (as between those parties) of such agreed signatures or certificates; and the question of whether draft article 13 should address both certificates and signatures should be reconsidered when decisions on the substantive articles of the draft Uniform Rules had been made.

35. The Working Group agreed that, for continuation of the discussion at a later session, an alternative draft of article 13 should be prepared, based on the view that criteria set forth with respect to signatures or certificates should apply equally to foreign and domestic signatures or certificates. For that purpose, the substance of those criteria should be set forth in draft article 12, with a reference in draft article 13 to foreign information certifiers having to comply with the criteria set forth in draft article 12 in order to obtain recognition.

Article 1. *Sphere of application*

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

"These Rules apply to electronic signatures used in the context of commercial" relationships and do not override any law intended for the protection of consumers."

37. At the outset, it was noted that draft article 1, which reproduced a number of provisions contained in article 1 of the Model Law, was based on the working assumption that the Uniform Rules should be prepared as a separate legal instrument and not merely as a separate chapter of the Model Law (see A/CN.9/WG.IV/WP.82, para. 16). While the view was expressed that the possible adoption of the Uniform Rules as an additional part of the Model Law might need to be reconsidered at a later stage, the Working Group agreed with that working assumption. It was also agreed that, in drafting the Uniform Rules, every effort should be made to ensure consistency with both the substance and the terminology of the Model Law. In the explanatory note, or guide to enactment of the Uniform Rules, possibly to be prepared at a later stage, explanations should be provided regarding the relationship between the Uniform Rules and the Model Law. In that context, it should be indicated that the Uniform Rules could be enacted either independently or as an addition to the Model Law.

38. General support was expressed for the substance of draft article 1. As a matter of drafting, it was agreed that, in order to ensure consistency with the terminology used in article 1 of the Model Law, the words "commercial relationships" should be replaced by the words "commercial activities". It was also agreed that the words "These Rules apply to electronic signatures used ..." did not sufficiently reflect the broad scope of the Uniform Rules and should be replaced by the words "These Rules apply where electronic signatures are used ...".

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

39. With respect to the reference to "commercial activities", doubts were expressed as to whether it was necessary to restrict the scope of the Uniform Rules to the commercial sphere. It was pointed out that the Uniform Rules should equally apply, for example, where electronic signatures were used in the submission of statements or other documents to public administrations. It was observed that the same discussion had taken place during the preparation of the Model Law. As indicated in the Guide to Enactment of the Model Law, it had been decided that "nothing in the Model Law should prevent an enacting State from extending the scope of the Model Law to cover uses of electronic commerce outside the commercial sphere" (Guide to Enactment of the Model Law, para. 26). It was generally agreed that the same policy should apply with respect to electronic signatures. Accordingly, it was decided that wording along the lines of footnote *** to article 1 of the Model Law should be inserted in the revised version of draft article 1 to be prepared for continuation of the discussion at a future session.

40. As regards the definition of the term "commercial" a question was raised about the relevance of the wording "relationships of a commercial nature, whether contractual or not". However, it was generally felt that, while relationships of a commercial nature might be regarded as inherently contractual in certain countries, they might also be regarded as non-contractual under the laws of other countries. In addition, it was noted that the same definition of the term "commercial" had been successfully used in other UNCITRAL texts.

41. A suggestion was made that uses of electronic signatures involving consumers should be excluded from the scope of the Uniform Rules. It was recalled that the matter of consumers had been considered by the Working Group at its previous session (see A/CN.9/457, paras. 20, 56 and 70). After discussion, the Working Group reaffirmed the decision made at that session not to displace any law intended for the protection of consumers. However, under that same decision, consumers should not be excluded from the scope of the Uniform Rules since there might be cases where the Uniform Rules might prove useful to consumers.

42. After discussing draft article 1, the Working Group decided to postpone consideration of the definitions contained in draft article 2 until it had completed its review of the substantive provisions of the Uniform Rules.

Article 3. *[Non-discrimination] [Technology neutrality]*

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

> "[None of the provisions of these Rules shall be applied] [The provisions of these Rules shall not be applied] so as to exclude, restrict, or deprive of legal effect any method [of signature] that satisfies the requirements of *[article 7 of the UNCITRAL Model Law on Electronic Commerce*]."

44. General support was expressed in the Working Group for a principle along the lines of draft article 3 which made it clear that the Uniform Rules were not intended to give a privilege or benefit to the use of certain technologies which might result in discrimination against the use of other technologies. The Working Group reaffirmed the importance of the principle of technology neutrality upon which the Model Law was based, and which was also an essential element of the Working Group's mandate for the preparation of the Uniform Rules.

45. Some concerns were expressed as to how the rule on non-discrimination should be formulated in the Uniform Rules, and about the relationship of that principle with article 7 of the Model Law. One issue was the role of party autonomy in draft article 3. The view was expressed that any reference to article 7 of the Model Law, since article 7 was a mandatory provision and not subject to variation by agreement, would limit the ability of the parties to agree on how to conduct their transactions between themselves and, in particular, on what might constitute a signature. Suggestions were made to address this issue by deleting the reference to article 7 and ending the draft article after the word "method" or by making draft article 3 subject to the party autonomy provisions of draft article 5. Under the first suggestion, draft article 3 would be a general statement of non-discrimination. Under the second suggestion, draft article 3 could be varied by agreement pursuant to draft article 5. An opposing view was that the focus of draft article 3 was upon the actions a State might take in legislating for the recognition (or legal effect) of different forms of technology. In that context, the issue of party autonomy was not relevant. An additional observation was that, while article 7 of the Model Law provided a means of establishing a functional equivalent for requirements of law for a signature, it did not exclude methods of signature that might still have legal effect even if they did not satisfy those form requirements. For that reason also the question of party autonomy was not relevant to a consideration of draft article 3.

46. Another concern expressed about the relationship of draft article 3 to article 7 of the Model Law was that, since the Uniform Rules could be an independent or free-standing text, draft article 3 would have little meaning to those States which did not adopt the Model Law or, at least, article 7 of the Model Law. To address this difficulty, one suggestion was that draft article 3 should refer to the provisions of the law of the State (being the State which was enacting the Uniform Rules) which dealt with signatures or electronic signatures. It was pointed out that the purpose of the reference to article 7 was to go beyond recognizing signatures which were given legal effect in national law and to offer the criterion in article 7 for those States looking to adopt new law on signatures. For that purpose, the reference in draft article 3 could be either a specific reference to article 7, a reference to the criteria set forth in article 7 or a reference to draft article 6(2) of the Uniform Rules which repeated the criteria of article 7. It was pointed out that a reference to the criteria of article 7 would have the advantage of preserving those criteria in the Uniform Rules since countries which adopted the Model Law could modify or vary article 7 to lower the effect of the criteria. If the proposal to adopt a reference to national law were followed, that reference to national law would then be a reference to something other than the criteria of article 7 of the Model Law. Support was expressed in favour of both a reference to the criteria of article 7, whether by reproducing them in the draft article directly or by a reference to draft article 6(2), and a reference to applicable law.

47. A number of suggestions of a drafting nature were made. Support was expressed for the first set of opening words "None of the provisions of these Rules ...". Support was expressed in favour of both retaining and deleting the words "[of signature]" and for adding the qualification "electronic" before "signature". The Working Group agreed that this was a question of drafting which depended upon what, if any, words were used to end the sentence. A further suggestion was made to replace "deprive of legal effect" with the words "discriminate against", but this proposal did not receive support. Support was expressed in favour of both alternatives shown in square brackets as a heading for draft article 3. A further proposal was for the heading "Equal treatment of electronic signatures". A degree of preference was expressed for a reference to the principle of technology neutrality in the title of draft article 3.

48. After discussion, the Working Group agreed: that an article along the lines of draft article 3 was very important to ensure that the principle of non-discrimination applied as between different types of signature technology, whether that technology was currently being used or technology that might be developed in the future; that there was no connection between draft articles 3 and 5 of the Uniform Rules and, therefore, no provision for variation by agreement in draft article 3 was necessary; that the opening words of draft article 3 should be "None of the provisions of these Rules ..."; that, while there was some preference for the heading of draft article 3 to be "Technology neutrality", the secretariat might wish to consider other possible titles to reflect the views expressed by the Working Group; that the reference to article 7 of the Model Law, although intended only to be a reference to article 7 as enacted by adopting States, should be replaced by a reference to draft article 6(2) of the Uniform Rules including the criteria set out in article 7 of the Model Law (as originally proposed and set out in A/CN.9/457 at para. 55); that, as an addition to the reference to draft article 6(2), the words "or otherwise meets the requirements of applicable law" should be included for later consideration by the Working Group.

Article 4. *Interpretation*

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

"(1) In the interpretation of these Uniform Rules, regard is to be had to their international origin and to the need to promote uniformity in their application and the observance of good faith in electronic commerce.

"(2) Questions concerning matters governed by these Uniform Rules which are not expressly settled in them are to be settled in conformity with the general principles on which these Uniform Rules are based."

50. There was general support for article 4 as drafted, although some doubts were expressed as to the meaning of the words "in electronic commerce" in paragraph (1). It was pointed out that electronic commerce was not a defined term. Although the meaning of the term was discussed in the Guide to Enactment of the Model Law, the view was expressed that this was not sufficient and that, should a reference to good faith "in electronic commerce" be retained, the text of the Uniform Rules should make it clear what the precise scope of these words was to be. Another view was that these words might assist in defining the sphere in which the requirement of good faith was to operate, in much the same manner as adopted in other UNCITRAL texts. These included, for example, article 7 of the United Nations Convention on Contracts for the International Sale of Goods ("The Sales Convention"), which referred to good faith "in international trade", and article 5 of the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit which referred to good faith "in the international practice of independent guarantees and stand-by letters of credit". After discussion, however, it was decided that the words "in electronic commerce" should be deleted.

Article 5. *Variation by agreement*

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

Variant A

"[By agreement, whether express or implied, parties are free to derogate from or vary any aspect of these Rules,] [Any aspect of these Rules may be derogated from or varied by agreement, whether express or implied,] except to the extent such derogation or variation would adversely affect rights of third parties."

Variant B

"(1) These Rules do not affect any right that may exist to modify by agreement any rule of law referred to in articles 6 and 7.

"(2) Any aspect of articles 9 to 12 of these Rules may be derogated from or varied by agreement, whether express or implied, except to the extent that such derogation or variation would adversely affect rights of third parties."

General remarks

52. In relation to the general principle of party autonomy, it was stated that the only limitation that the Uniform Rules should impose upon commercial parties in respect of regulating commercial matters as between themselves and in respect of third parties, should be the limitations imposed in the laws of enacting States.

53. In respect of both Variants A and B, there was support for the deletion of the phrases dealing with the rights of third parties. It was stated that this principle, together with the principle that parties could not affect, by agreement, provisions of mandatory law, was internationally recognized as fundamental and therefore did not need to be expressed in the Uniform Rules. Another view was that the reference to the rights and obligations of third parties would fall within the more general category of an exception to party autonomy based on public policy reasons, an exception which might usefully be stated in this article. An opposing view was that issues of public policy should be left to domestic law and not addressed in the Uniform Rules.

54. The Working Group exchanged views on the heading of draft article 5 and a number of suggestions for revision were made including "Party autonomy" and "Freedom of contract". After discussion, the Working Group requested the secretariat to take these views into consideration when revising draft article 5.

Variant A

55. Various views were expressed in support of Variant A. One view was that, because the rule set out in Variant B specified which articles of the Uniform Rules were to be regarded as mandatory rules, it expressed the principle of party autonomy more narrowly than the rule in Variant A. Variant B might thus have the effect of inhibiting, rather than facilitating, the development of electronic commerce. It was pointed out that an absence of regulation had greatly facilitated the development of electronic data interchange and allowed parties to develop contractual means of addressing legal issues that arose. For the same reasons, the Uniform Rules should not seek to create mandatory provisions such as those set forth in Variant B. Another view was that, in a commercial context, parties should have complete freedom to agree on how their relationships and transactions should be conducted, including on what they might agree to treat as a signature. It was acknowledged that, while commercial parties could certainly conclude such agreements "as between themselves", there was some doubt as to how such an agreement could be legally effective where form requirements applied to the commercial context.

56. It was suggested, however, that the decision on whether certain articles of the Uniform Rules should be mandatory could be taken at a later stage of the Working Group's deliberations and, if necessary, included in the relevant articles, rather than diluting the article on party autonomy. To reflect this suggestion, it was proposed that the opening words of Variant A could be amended to read "Unless these Rules provide otherwise ...".

57. As a matter of drafting, it was suggested that the reference to "express or implied" agreement should be deleted and that the word "modify" should be substituted for "derogate". In view of the subsequent decisions of the Working Group these suggested changes were not pursued.

Variant B

58. Support was expressed in favour of Variant B. It was pointed out that draft paragraphs (1) and (2) were closely modelled upon article 4 of the Model Law. Accordingly, draft articles 6 and 7 of the Uniform Rules, like articles 7 and 8 of the Model Law upon which they were based, would be mandatory provisions. Similarly, in accordance with article 4 paragraph (2), draft paragraph (1) of Variant B preserved the right of parties to modify mandatory provisions where national law would allow them to do so. Draft articles 9 to 12 of the Uniform Rules, in comparison, were provisions from which parties could freely derogate, like those provisions of chapter III of the Model Law.

59. With a view to addressing some of the views and concerns that had been expressed in relation to both variants, a provision on party autonomy along the following lines was proposed:

"These Rules may be derogated from or varied by agreement unless:

(a) these Rules provide otherwise;

(b) the law of the enacting State provides otherwise."

60. This proposal was generally supported. Some concern was expressed, however, as to paragraph *(b)* on the basis that it was a very broad provision which left it open to States to impose restrictive regulations on the use of electronic signatures and did not encourage adoption of a standard such as article 7 of the Model Law. It was noted by the Working Group that, while it would be impossible to prevent a State from adopting such a position, the intention that restrictive provisions should be exceptional, rather than general, could be mentioned in a guide or explanatory report to the Uniform Rules. A further proposal was that paragraph *(b)* should be placed in square brackets, pending further consideration by the Working Group. After discussion, the Working Group adopted that proposal.

61. A suggestion of a drafting nature was that the provision should refer to derogation or variation of "the effect" of the Rules, rather than from the Rules themselves. It was agreed that, because this type of provision was found in a number of international instruments (e.g. the Sales Convention), the common formulation should be followed.

Article 6. [Compliance with requirements for signature][Presumption of signing]

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

"Variant A

"(1) Where, in relation to a data message, an enhanced electronic signature is used, it is presumed that the data message is signed.

"(2) Where the law requires a signature of a person, that requirement is met in relation to a data message if an electronic signature is used which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

"[(3) Where the law requires a signature of a person, that requirement is met in relation to a data message if an enhanced electronic signature is used.]

"(4) Paragraphs (2) and (3) apply whether the requirement referred to therein is in the form of an obligation or whether the law simply provides consequences for the absence of a signature.

"(5) The provisions of this article do not apply to the following: [...].

"Variant B

"(1) Where, in relation to a data message, [a method] [an electronic signature] is used which:

(a) is unique to the signature holder [for the purpose for][within the context in] which it is used;

[*(b)* can be used to objectively identify the signature holder in relation to the data message; and]

(c) was created and affixed to the data message by the signature holder or using a means under the sole control of the signature holder [and not by any other person];

it is presumed that the data message is signed.

"(2) Where the law requires a signature of a person, that requirement is met in relation to a data message if an electronic signature is used which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

"(3) Paragraph (2) applies whether the requirement referred to therein is in the form of an obligation or whether the law simply provides consequences for the absence of a signature.

"(4) The provisions of this article do not apply to the following: [...]".

Purpose of draft article 6

63. There was general agreement that the main purpose of draft article 6 should be to establish a degree of certainty as to the legal effects that would flow from the use of electronic signatures. As to what those legal effects might be, the discussion developed in various directions, with constant reference being made to the question of fulfilment of the signature requirements referred to in article 7 of the Model Law.

Types of electronic signatures.

64. A view was expressed that (either through a reference to the notion of "enhanced electronic signature" or through a direct mention of criteria for establishing the technical reliability of a given signature technique) a dual purpose of draft article 6 should be to establish: (1) that legal effects would result from the application of those electronic signature techniques that were recognized as reliable; and (2), conversely, that no such legal effects would flow from the use of techniques of a lesser reliability. It was generally felt, however, that a more subtle distinction might need to be drawn between the various possible electronic signature techniques, since the Uniform Rules should avoid discriminating against any form of electronic signature, unsophisticated and insecure though it might appear in given circumstances. Therefore, any electronic signature technique applied for the purpose of signing a data message under article 7(1)*(a)* of the Model Law would be likely to produce legal effects, provided that it was sufficiently reliable in the light of all the circumstances, including any agreement between the parties. However, the determination of what constituted a reliable method of signature in the light of the circumstances could only be made under article 7 of the Model Law by a court or other trier of fact intervening ex post, possibly long after the electronic signature had been used. In contrast, the benefit expected from the Uniform Rules in favour of certain techniques, which were recognized as particularly reliable, irrespective of the circumstances in which they were used, was to create certainty (through either a presumption or a substantive rule), at or before the time any such technique of electronic signature was used (ex ante), that it would result in legal effects equivalent to those of a handwritten signature.

65. A question was raised as to whether any legal effect should result from uses of electronic signature techniques that would not fulfil all the functions described in article 7(1)*(a)* of the Model Law, namely those uses of electronic signatures that would not be made with the intent of indicating any approval of the information contained in the data message. It was generally felt that, by appending a signature (whether handwritten or electronic) to certain information, the alleged signer should be presumed to have approved the linking of its identity with that information. Whether that linking should produce legal effects (contractual or other) would result from the nature of the information being signed, and from any other circumstances, to be assessed according to the law applicable outside the Uniform Rules. In that context, the Working Group agreed that the Uniform Rules should not interfere with the general law of contracts or obligations.

66. It was noted that Variants A and B, while intended to produce the same result in practice, differed as to whether they relied or not on the notion of "enhanced electronic signature". Support was expressed in favour of retaining the notion of enhanced electronic signature, which was described as particularly apt to provide certainty with respect to the use of a certain type of electronic signatures, namely digital signatures implemented through public-key infrastructure (PKI). In response, it was pointed out that the notion of "enhanced electronic signature" made the structure of the Uniform Rules unnecessarily complex. In addition, the notion of "enhanced electronic signature" would lend itself to misinterpretation by suggesting that various layers of technical reliability might correspond to an equally diversified range of legal effects. Widespread concern was expressed that an enhanced electronic signature would be considered as if it were a distinct legal concept, rather than just a description of a collection of technical criteria, the use of which made a method of signing particularly reliable. While postponing its final decision as to whether the Uniform Rules would rely on the notion of "enhanced electronic signature", the Working Group generally agreed that, in preparing a revised draft of the Uniform Rules for continuation of the discussion at a future session, it would be useful to introduce a version of the draft articles that did not rely on that notion.

Relationship with article 7 of the Model Law

67. A view was expressed that the reference to article 7 of the Model Law in paragraph (2) of draft article 6 (which was also useful as a reminder of the conceptual origin of the Uniform Rules) was to be interpreted as limiting the scope of the Uniform Rules to situations where an electronic signature was used to meet a mandatory requirement of law that certain documents had to be signed for validity purposes. Under that view, since the law contained very few such requirements with respect to documents used for commercial transactions, the scope of the Uniform Rules was very narrow. It was generally agreed, in response, that such interpretation of draft article 6 (and of article 7 of the Model Law) was inconsistent with the interpretation of the

words "the law" adopted by the Commission in paragraph 68 of the Guide to Enactment of the Model Law, under which "the words 'the law' are to be understood as encompassing not only statutory or regulatory law but also judicially-created law and other procedural law". While paragraph (1) of both Variant A and Variant B contained no reference to any "requirement of law", and paragraph (2) mirrored the wording of article 7 of the Model Law, it was widely understood that there was no difference in scope between the two paragraphs, and that scope was particularly broad since most documents used in the context of commercial transactions were likely to be faced, in practice, with the requirements of the law of evidence regarding proof in writing.

Legal effect: presumption or substantive rule

68. Various views were expressed as to precisely what legal effect should result from the use of a reliable electronic signature. One view was that the question whether the document should be regarded as "signed" should be distinguished from the question whether it should be regarded as signed by any specific person. Another view was that establishing a presumption that the information was "signed" would be inappropriate since, under the laws of a number of countries, "signature" indicated the intent of the signer to be bound, for example in a contractual environment. Presuming intent might place an excessive burden on the alleged signer, and might interfere with the existing law dealing with the formation of contracts or obligations. Accordingly, it was suggested that, instead of establishing a presumption that the data message was "signed", the Uniform Rules should merely establish the presumption of a link between the electronic signature and the alleged signer, together with a presumption as to the reliability of the signature technique being used. It was also suggested that any additional conclusion regarding the effect of the electronic signature with respect to the substance of the data message should be left to other applicable law. Some support was expressed in favour of those views.

69. A related view was that the approach taken in draft article 6 in combination with the definition of "electronic signature" in draft article 2 was acceptable. Under that approach, the use of a reliable electronic signature should result in the data message being "signed" by the holder of the signature device, on the assumption that the consequences of such a "signature", in particular as to any intent of the alleged signer regarding the information contained in the data message, would be dealt with by the law applicable outside the Uniform Rules.

70. The Working Group generally agreed that the focus of draft article 6 should be on replicating in an electronic environment the legal consequences of the use of a handwritten signature. Based on the view that the use of the verb "signed" was, in some countries, inappropriate in the context of data messages, it was suggested that the functional equivalent of the word should be assumed in the discussion, except where the context indicated a handwritten signature. The Working Group proceeded with a discussion as to whether the legal effects of the use of a reliable electronic signature device should be expressed by way of a presumption or through a substantive rule.

71. As an alternative to establishing a presumption, which might be regarded in certain legal systems as narrowly restricted to the realm of civil procedure, it was suggested that an operative provision was needed to recognize legal effects to the use of electronic signatures. It was suggested that a rule along the following lines should be adopted, based on the text of paragraph (1) of Variant A: "Where, in relation to a data message, an electronic signature is used, that electronic signature is given the same legal effect [as there would be if the information in the data message had been in writing and signed][as is given to a handwritten signature under applicable law]". It was pointed out that wording along the same lines could be prepared based on paragraph (1) of Variant B. Some support was expressed in favour of that suggestion. While a view was expressed that the principle embodied in the suggested text should apply to all electronic signatures, it was pointed out by a number of delegations that the operative provision should be limited in scope to cover only those electronic signatures which were described as "enhanced" under draft article 2.

72. A widely shared view, however, was that draft article 6 was appropriately drafted in the form of a rebuttable presumption. Support was expressed in favour of the view that a rebuttable presumption of "signature" by the alleged signer was the most appropriate effect that could result from the use of a reliable signature technique. The effect of such a presumption would be to place on the alleged signer the burden of proving that the electronic signature should not be attributed to that person or that it should not be treated as binding. In that context, while concern was expressed as to how the alleged signer would rebut the presumption, for example in the context of contract formation, it was recalled that the Uniform Rules merely established the equivalence between certain electronic and handwritten signatures, and did not intend to interfere with the general law of contracts or obligations.

73. The view was expressed that, irrespective of whether draft article 6 established a presumption that the data was "signed" or a mere presumption that the electronic signature was technically reliable and linked to a given message, the burden of rebutting such presumptions might be too onerous in the context of consumer transactions, which might need to be excluded from the scope of draft article 6.

74. With respect to the nature of the presumption to be established, the view was expressed that, while the substance of the suggestion for a substantive rule (see above, para. 71) should be reflected in draft article 6, there was a need for establishing a presumption, which should be more reflective of the evidentiary context in which it would be used. It was pointed out that creating a presumption purely for evidentiary purposes might be less ambitious but more feasible than establishing general criteria of reliability under which data messages should be presumed to be "signed". On the one hand, technical reliability was a rapidly evolving reality. Technical criteria might thus prove extremely difficult to express in sufficiently neutral terms to stand the test of time. On the other hand, changing practices in the use of electronic signatures required a flexible criterion, such as embodied in article 7 (1)*(b)* of the Model Law, more than an all-purpose test of reliability along the

lines of draft article 6 (1). With a view to illustrating the suggested approach, the following text was proposed for draft article 6:

"Article 6. *Presumptions affecting electronic signatures*

"(1) The legal consequences of the use of a signature shall apply equally to the use of electronic signatures.

"(2) Where the law requires a signature of a person, that requirement is met in relation to a data message if an electronic signature is used which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

"(3) If the requirements of paragraph (4) are met, a judicial or administrative tribunal is entitled to presume that an electronic signature proves one or more of the following matters:

(a) that the electronic signature meets the standard of reliability set out in paragraph (2);

(b) the identity of the alleged signer;

(c) that the alleged signer approved the data message to which the electronic signature relates.

"(4) The presumptions in paragraph (3) shall apply if, and only if

(a) a notice is served* on the alleged signer by the person relying on the electronic signature asserting that a specified electronic signature proves one or more of the matters set out in subparagraphs *(a)* to *(c)* of paragraph (3); and

(b) the alleged signer fails to serve* a notice which denies one or more of the matters set out in the notice under subparagraph *(a)* and provides the grounds of that objection.

75. Support was expressed in favour of that proposal, particularly on the grounds that it would be applicable to consumer transactions, since rebuttal of the presumption could result from a simple notice of objection. However, it was generally felt, particularly with respect to proposed new paragraphs (3) and (4) that the suggested wording might be overly geared to evidentiary practices in judicial proceedings as they were known in certain legal systems, and might be difficult to rephrase in sufficiently neutral terms to adapt to all legal systems. In general, it was found that the proposed text of paragraph (4) went too deeply into harmonizing the rules of civil procedure, an area which did not easily lend itself to treatment by international instruments. With respect to paragraphs (1) and (2), the view was expressed that the interplay of the two provisions might need to be reconsidered to avoid a possible misinterpretation under which unqualified electronic signatures would be treated more favourably than those electronic signatures that met criteria of reliability.

76. In response to the objection expressed with respect to the proposed text of new paragraphs (3) and (4), an alternative to those paragraphs was proposed in the form of a single paragraph (3) as follows:

"[(3) In the absence of proof to the contrary, reliance on an electronic signature shall be presumed to prove:

(a) that the electronic signature meets the standard of reliability set out in paragraph (2);

(b) the identity of the alleged signer; and

(c) that the alleged signer approved the data message to which the electronic signature relates.]"

77. It was felt that additional efforts should be made by the Working Group at a future session to determine whether an acceptable rule of procedure could be drafted, to the effect that, where the alleged signer intended to dispute its signature, it should promptly advise the relying party, and disclose the reasonable grounds for such a dispute. In that connection, it was suggested that inspiration might be drawn from article 16 of the UNCITRAL Model Law on Cross-border Insolvency. In response to that suggestion, however, it was pointed out that, while limited harmonization of civil procedure was conceivable in the narrow context of cross-border insolvency, it might be more difficult to achieve with respect to the broader issues of electronic signatures.

Criteria of reliability of an electronic signature

78. In the context of the above discussion regarding the formulation of draft article 6 as a rebuttable presumption, particular attention was given to the criteria against which the technical reliability of the signature technique should be measured. With a view to expressing more objectively the criteria set forth in paragraph (1) of Variant B, the following proposal was made for draft article 6:

"Article 6. *Compliance with legal requirements for signature*

"(1) Where the law requires a signature of a person, that requirement is met in relation to a data message if a method is used which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

"(2) It is presumed that a method is reliable for the purpose of satisfying the requirement referred to in paragraph (1) if that method ensures that:

(a) the data used for the creation of an electronic signature are unique to the holder of the signature creation device within the context in which the device is used;

(b) the holder of the signature creation device has sole control of that device;

(c) the electronic signature is linked to the data message to which it relates [in a manner which guarantees the integrity of the message];

(d) the holder of the signature creation device is objectively identified within the context [in which the device is used][of the data message]."

"*Requirements as to service (including timing) are to be dealt with under the applicable law. Some States may wish to add provisions to deal with those matters."

79. Considerable support was expressed in favour of expressing draft article 6 as a presumption of technical reliability. Doubts were expressed, however, as to whether it was necessary to establish detailed technical criteria to measure such reliability. The view was expressed that, in most practical circumstances, reliability would be pre-determined, either by agreement between the parties, or through reliance on an existing public or private PKI. While there was widespread agreement with that view, it was also felt that it was desirable to offer default criteria for assessing the technical reliability of electronic signature techniques, for consideration mainly by countries that did not already have established PKI.

80. With respect to the individual criteria proposed, it was pointed out that the Uniform Rules or any guide to enactment or explanatory note that might be prepared at a later stage would need to clarify the following issues: (1) provisions under which the signature creation device should be under the sole control of the corresponding device holder should not interfere with the law of agency or with the operation of the device holder through an electronic agent; and (2) the "objective identification" of the device holder should not imply that, in all cases, an individual person should be identified by name, since the notion of "identity" should be interpreted as referring possibly to significant characteristics of the device holder, such as position or authority, either in combination with a name or without reference to a name (see A/CN.9/WG.IV/WP.82, para. 29). In addition, questions were raised as to whether the reference to the integrity of the message should be regarded as appropriate in the context of establishing whether a data message was "signed", since the verification of "integrity" was not inherently part of any signature process (whether electronic or handwritten) and might seem more pertinent in the context of assessing whether that message should be regarded as "original".

81. More generally with respect to criteria for assessing the reliability of a signing method, the view was expressed that any such criteria should be drafted so as to support the presumption, and should not amount to proving independently the conclusion which was to be presumed. It was suggested that the criteria for recognition of foreign certificates in draft article 13, and perhaps the responsibilities of an information certifier in draft article 12, could furnish useful additional criteria against which to measure reliability. It was further suggested that the criteria in Variant B gave little or no help in deciding whether a signing method was reliable. Most if not all of them would apply to any method at all. It was stated that, in establishing criteria, the principal objective should be to determine the degree of confidence that could be derived from satisfying such criteria. Even digital signatures supported by certificates offered a range of distinct levels of assurance. It was pointed out that the Working Group had not yet agreed on the level of assurance needed for the proposed presumption.

82. After discussion, the Working Group agreed that the discussion of draft article 6 should be resumed at a future session. The secretariat was requested to prepare a revised draft of article 6 to reflect, as possible variants, the above-mentioned views and concerns. In preparing those variants, the secretariat should consider a version of draft article 6 that would combine the approaches suggested in paragraphs 74, 76 and 78 above, together with paragraphs (3) and (4) of Variant B.

Article 7. *[Presumption of original]*

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

> "(1) Where, in relation to a data message, [an enhanced electronic signature is used] [an electronic signature [a method] is used which provides a reliable assurance as to the integrity of the information from the time when it was first generated in its final form, as a data message or otherwise], it is presumed that the data message is an original.
>
> "(2) The provisions of this article do not apply to the following: [...]."

84. A number of concerns were raised as to the purpose of draft article 7 and whether it was necessary to include such an article in the Uniform Rules. It was pointed out that the purpose of draft article 7 was to establish that the criteria for reliable assurance as to the integrity of the information in a data message (in the context of an original in article 8 of the Model Law) could be met, or would be presumed to be met, by the use of a method of electronic signature. One concern was that the use of a signature as a means of satisfying the criteria of reliable assurance as to integrity in article 8 of the Model Law might not be appropriate to the concept of originality and might have the effect of imposing the use of a signature on a requirement for an original, where a signature might not otherwise be necessary. In addition, the view was expressed that it was not clear how draft article 7 would operate when what was required was a unique original. It was also suggested that the use of a particular method of signature to establish a presumption of originality might be interpreted as departing from the flexible test established in paragraph (3) of article 8 of the Model Law, and might not be technologically neutral.

85. Another concern was that, if the purpose of draft article 7 was to provide a means by which the criteria in article 8 could be satisfied, not only paragraphs (1)*(a)* but also paragraph (1)*(b)* of article 8 should be referred to in draft article 7. Similarly, it was pointed out that the establishment of a presumption of an "original" in draft article 7 was not fully consistent with article 8 of the Model Law, which referred to information in "original form". Since the idea of an "original" was difficult to understand in the context of electronic commerce, the presumption in draft article 7 should refer to the data message as having the value of an original or as being the equivalent of an original. A further view was that the focus of draft article 7 in relation to the integrity of the data message should be to establish that, by the use of a method of signature, the data message could be presumed not to have been altered; the issue should not be whether the data message satisfied a requirement for an original, since this was addressed in article 8 of the Model Law.

86. On the issue of how draft article 7 would function in practice, it was pointed out that there was an element of

circularity in the current drafting. It was suggested that, in essence, draft article 7 provided that, where a method could demonstrate integrity by reference to certain technical criteria and that method was used, the benefit of a presumption of integrity was obtained. In that case, however, integrity would be proven by the use of the method and was therefore a matter of fact, not a matter to be presumed. Similarly, if draft article 7 were to refer to the use of an enhanced electronic signature, use of such a signature would lead to a presumption of integrity. When considered in the light of the definition of enhanced electronic signature in draft article 2, however, draft article 7 would have little meaning because integrity was potentially a feature of an enhanced electronic signature.

87. In support of retaining draft article 7, it was pointed out that, if the Uniform Rules were to be a text independent of the Model Law, draft article 7 might serve a useful function, especially in situations where the Model Law, or at least article 8, was not adopted. To reflect this concept more clearly, and address a concern about repeating only a part, rather than the whole, of article 8 of the Model Law in draft article 7, it was proposed that the text should be amended as follows, and should be accompanied by a note in a guide explaining that, where it was not already adopted, States could enact article 8 of the Model Law in full:

> "A data message shall be presumed to be original information for the purposes of [*the law of the enacting State*] if it complies with the requirements of *[article 8 of the Model Law as enacted in the enacting State*]."

That proposal was not widely supported. A view was expressed, however, that the effect of all four paragraphs of article 8 of the Model Law should not be ignored.

88. Another view was that draft article 7 was useful in providing a means for establishing a guarantee of the integrity of the data message, especially where an enhanced electronic signature was used. A related view was that, if the issue of integrity was not to be addressed in the context of draft article 7, it might need to be considered for inclusion in draft article 6 as one of the criteria for a signature, along the lines proposed in the definition of "enhanced electronic signature" in draft article 2.

89. After discussion, the Working Group agreed that, for the purposes of further consideration, the Uniform Rules should include, in square brackets, a draft article 7 under which, where a method within draft article 6 was used and that method satisfied paragraph (1)*(a)* and *(b)* of article 8 of the Model Law (these paragraphs were to be repeated in full in the draft article), a presumption would be established that the data message was in original form. Such a provision would add to the Model Law by establishing a method of generating a signature which could establish a presumption of original form. In connection with that decision, it was also agreed that, while the revised version of draft article 7 to be prepared by the secretariat would no longer mention the notion of "enhanced electronic signature", it should not be interpreted as preempting the final decision of the Working Group, to be made at a later stage, as to whether the draft Uniform Rules would refer to that notion or not.

Article 8. *Determination of [enhanced] electronic signature*

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

> (1) *[The organ or authority specified by the enacting State as competent]* may determine [that an electronic signature is an enhanced electronic signature] [which [methods][electronic signatures] satisfy the requirements of articles 6 and 7].
>
> (2) Any determination made under paragraph (1) should be consistent with recognized international standards.

91. Support was expressed in favour of retaining draft article 8. One view was that, while the draft article was not an enabling provision that could, or would, necessarily be enacted by States in its present form, it nevertheless gave a clear message that certainty and predictability could be achieved by determining which signature techniques satisfied the reliability criteria of draft articles 6 and 7, provided that such determination was made in accordance with international standards. It was further emphasized that what was required to facilitate the development of electronic commerce was certainty and predictability at the time when commercial parties might use a signature technique, not at the time when there was a dispute before the courts. Where a particular signature technique could satisfy requirements for a higher degree of reliability and security, there should be a means for assessing the technical aspects of reliability and security and according the signature technique some form of recognition, such as provided by the mechanism of draft article 8.

92. On the issue of satisfaction of the reliability criteria of draft article 6, a proposal was made that what should be considered was not the satisfaction of those criteria in absolute terms, but the extent to which a particular technology could satisfy those criteria. That proposal was supported.

93. Concern was expressed, however, that the draft article should not be interpreted in a manner that would either prescribe mandatory legal effects for the use of certain types of signature techniques, or would restrict the use of technology to those techniques determined to satisfy the reliability requirements of draft articles 6 and 7. Parties should be free, for example, to use techniques which had not been determined to satisfy draft articles 6 and 7, if that was what they had agreed to do. They should also be free to show, before a court or arbitral tribunal, that the method of signature they had chosen to use did satisfy the requirements of draft articles 6 and 7, even though not the subject of a prior determination to that effect. A related concern was that the draft article should not be seen as making a recommendation to States as to the only means of achieving recognition of signature technologies, but rather as indicating the limitations that should apply if States wished to adopt such an approach. It was suggested that these points should be clearly explained, possibly in a guide to the Uniform Rules.

94. Doubts were expressed as to the role of the State in making the determinations referred to in paragraph (1). One view was that any organ or authority set up to assess technical reliability of signature techniques should be industry-based. Another view was that the draft article should not focus on the question of who or what might be authorized to make the determination, but rather on the matters to be considered if any determination was to be made. Concern was also expressed as to the meaning of the words "recognized international standards". It was pointed out that reference to "recognized" standards might raise questions as to what would constitute a recognized standard and of whom recognition was required. It was also suggested that the word "standard" needed to be interpreted in a broad sense which would include industry practices and trade usages, texts emanating from such organizations as the International Chamber of Commerce, as well as the work of UNCITRAL itself (including these Rules and the Model Law); it should not be limited to official standards developed, for example, by the International Organization for Standardization (ISO) and the Internet Engineering Task Force (IETF). To address these concerns, it was suggested that the reference to "recognized standards" could be replaced with "relevant standards" and an explanation of these matters included in a guide to the Uniform Rules.

95. To reflect some of the above doubts and concerns, the following proposals were made as possible substitutes for the text of draft article 8:

"*(a)* Any determination by [*the State*] as to which electronic signatures satisfy the requirements of article 6 shall be consistent with recognized international standards.

"*(b)* The enacting State may appoint an organ or authority to make a determination as to what technologies or electronic signatures, in accordance with international standards, would satisfy articles 6 and 7.

"*(c)* In making a determination that electronic signatures are entitled to the presumptions of articles 6 and 7 due regard shall be had to recognized international standards.

"*(d)* One or more methods of electronic signature [provided such methods conform with recognized international standards] may be determined as satisfying a priori the requirements of articles 6 and 7."

96. Considerable support was expressed in favour of the principles set forth in these various options. It was observed that the first two proposed paragraphs included a reference to the body that might make the determination, while the second two proposed paragraphs focused on the determination itself.

97. As a matter of drafting, with respect to paragraph (1) of draft article 8, support was expressed in favour of the alternative words "which methods satisfy the requirements of articles 6 and 7". With respect to paragraph (2), it was suggested that the word "shall" should replace the word "should".

98. After discussion, the Working Group agreed that: (1) the revision of draft article 8 should reflect, possibly as two variants, the proposals set forth above; (2) a guide or explanatory note to the Uniform Rules should make it clear that the mechanism referred to in draft article 8 for making a determination as to satisfaction of the requirements of draft articles 6 and 7 was not the only means of achieving certainty and predictability in signature techniques; (3) it should also be made clear that less emphasis should be placed on the role of the State in making this determination and more on the establishment of some other organ or authority; (4) the draft article should only refer to the use of electronic signatures and references to enhanced electronic signatures should be deleted, however without preempting the final decision of the Working Group, to be made at a later stage, as to whether the Uniform Rules would refer to that notion or not; (5) any determination made within the meaning of this draft article should be in accordance with international standards; and (6) any determination made should take into account not only whether certain methods satisfied the requirements of draft articles 6 and 7 but also the degree or extent to which those requirements were met.

Article 9. *[Responsibilities] [duties] of the signature holder*

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

"(1) A signature holder [has a duty to] [shall]:

(a) Exercise due diligence to ensure the accuracy and completeness of all material representations made by the signature holder which are relevant to issuing, suspending or revoking a certificate, or which are included in the certificate.

(b) Notify appropriate persons without undue delay in the event that [it knew its signature had been compromised] [its signature had or might have been compromised];

(c) Exercise due care to retain control and avoid unauthorized use of its signature, as of the time when the signature holder has sole control of the signature device.

"(2) If [there are joint holders][more than one person has control] of the [key][signature device], the [obligations] [duties] under paragraph (1) are joint and several.

"(3) A signature holder shall be [responsible][liable] for its failure to [fulfil the obligations [duties] in][satisfy the requirements of] paragraph (1).

"(4) [Liability of the signature holder may not exceed the loss which the signature holder foresaw or ought to have foreseen at the time of its failure in the light of facts or matters which the signature holder knew or ought to have known to be possible consequences of the signature holder's failure to [fulfil the obligations [duties] in][satisfy the requirements of] paragraph (1).]"

Title

100. It was generally agreed that, in order not to create confusion by using either the words "obligations" or "duties", which might connote different types of responsibilities and sanctions, in the various legal systems, the title of

draft article 9 should refer merely to "conduct" or "responsibilities" of the signature holder. With respect to the notion of "signature holder", the view was expressed that the term "signature device holder" would be more appropriate, since it would clarify the distinction to be made between the legal notion of "signature" on the one hand, and the technical concept of "signature device" on the other. While no decision was made by the Working Group in that respect, it was generally felt that the issue might need to be further considered in the context of draft article 2.

Paragraph (1)

101. For the same reasons as expressed regarding the title of draft article 9 (see above, para. 100), it was decided that the opening words of paragraph (1) should read "A signature holder shall" (for continuation of the discussion, see below, para. 105).

102. General support was expressed for the substance of subparagraph *(a)*. However, with respect to the verbs "issuing, suspending or revoking a certificate", it was generally felt that broader wording should be used to cover the entire life-cycle of the certificate. That life-cycle might begin before the certificate was actually issued, for example at the time when the information certifier received an application for issuance of the certificate. Similarly, the life-cycle might be extended beyond the time of expiry initially stipulated for a given certificate, for example in case of renewal or extension of the certificate. In view of the wide range of possible factual situations to be covered, it was agreed that a flexible formulation should be used to avoid the need to specify each event that might occur in relation to the certificate during its life-cycle. It was also agreed that the wording used in subparagraph *(a)* was not sufficiently neutral in that it might be read as implying that the signature device would necessarily involve the use of a certificate. With a view to making it clear that not all signature devices might rely on certificates, it was decided that the opening words of subparagraph *(a)* should read along the following lines: "Where the signature device involves the use of a certificate ...". For the same reason, it was decided that subparagraph *(a)* should be relocated after subparagraphs *(b)* and *(c)*. As a matter of drafting, it was agreed that the words "or which are included in the certificate" should be replaced by the words "or which are to be included in the certificate".

103. With respect to subparagraph *(b)*, wide support was expressed in favour of retaining words along the lines of "it knew that its electronic signature had or might have been compromised". A concern was expressed, however, that the rule might place excessive emphasis on a subjective determination of what the signature holder "knew". It was suggested that a more objective reference to what the signature holder "ought to have known" should be added to the current text. In response, it was recalled that the words "or ought to have known" had not been included in draft article 9 on the basis that it would be difficult for the signature holder to satisfy a duty of notification that was based on something it ought to have known, but did not in fact know. With a view to alleviating the expressed concern, the following text was proposed for subparagraph *(b)*:

"Notify appropriate persons without undue delay if

(i) the signature holder knows that the signature device has been compromised; or

(ii) the circumstances known to the signature holder give rise to a substantial risk that the signature device may have been compromised".

The Working Group accepted that proposal.

104. While the substance of subparagraph *(c)* was found to be generally acceptable, it was decided that no reference to the time when the signature holder had acquired sole control of the signature device was necessary. As a matter of drafting, it was decided that, to avoid any ambiguity as to the meaning of the notion of "control" of the signature device, the provision should read along the following lines: "Exercise due care to avoid unauthorized use of its signature". With a view to ensuring consistency in terminology, the secretariat was invited to consider whether a single term could be used instead of the two concepts of "due diligence" in subparagraph *(a)* and "due care" in subparagraph *(c)*. The term "reasonable care" was suggested as a possible substitute.

Paragraph (2)

105. The discussion focused on the issue whether, in a case where the signature device was held jointly by more than one holder, the liability for failure to meet the requirements in paragraph (1) should be joint and several. It was widely felt that paragraph (2) might inappropriately interfere with the law governing liability outside the Uniform Rules. As to the substance of the rule, it was stated that there were situations where it might be unfair to provide that each holder of the device was liable for the entire loss that might have resulted from unauthorized use of the device, e.g. in case of unauthorized use of a corporate signature device held by a number of employees. It was decided that each holder should only be liable to the extent that it had personally failed to meet the requirements in paragraph (1). To that effect, it was decided that paragraph (2) should be deleted, and that the opening words of paragraph (1) should read along the lines of: "Each signature device holder shall".

Paragraph (3)

106. The Working Group found the substance of paragraph (3) to be generally acceptable as a general statement of liability of a signature holder who failed to satisfy the requirements of paragraph (1). As a matter of drafting, a suggestion was made that the provision should read: "A signature holder shall assume the legal consequences for its failure to satisfy the requirements of paragraph (1)". After discussion, the Working Group decided that, in order not to suggest that the Uniform Rules dealt in any detail with the legal consequences of misconduct by the signature holder, paragraph (3) should read as follows "A signature holder shall be liable for its failure to satisfy the requirements of paragraph (1)".

Paragraph (4)

107. It was recalled that paragraph (4) was based upon article 74 of the Sales Convention. It established a rule based upon a test of foreseeability of damage, but was limited to breach of the obligations of the signature holder in paragraph (1). Concerns were expressed by the Working Group that the liability which might arise in the context of a contract for the sale of goods was not the same as the liability that might arise from the use of a signature, and could not be quantified in the same way. It was also stated that a test of foreseeability might not be appropriate in the context of the contractual relationship between the signature holder and the information certifier, although such a test might be appropriate in the context of the relationship between the signature holder and a relying party (for previous discussion, see A/CN.9/457, paras. 93-98). It was explained, in response, that establishing a test of foreseeability in the context of draft article 9 would merely amount to restating a basic rule which would apply under readily applicable law in many countries. Where that basic rule did not readily apply, paragraph (4) would provide useful guidance to courts and tribunals when assessing the liability of the signature holder, and avoid in practice the application of consequential or punitive damages that might largely exceed the amount of any damage reasonably foreseeable by the signature holder at the time when the electronic signature was applied.

108. The prevailing view, however, was that it might be difficult to achieve consensus as to what consequences might flow from the liability of the signature holder. Depending on the context in which the electronic signature was used, such consequences might range, under existing law, from the signature holder being bound by the contents of the message to a mere liability to pay damages. It was stated that the Uniform Rules should not embark on the preparation of any provision that might interfere with the general law of obligations. Accordingly, that matter was left to paragraph (3), which established the principle that the signature holder should be held liable for failure to meet the requirements of paragraph (1), and to the law applicable outside the Uniform Rules in each enacting State, with respect to the legal consequences that would flow from such liability. After discussion, the Working Group decided to delete paragraph (4).

Article 10. *Reliance on an enhanced electronic signature*

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

"(1) A person [is] [is not] entitled to rely on an enhanced electronic signature to the extent that it [is] [is not] reasonable to do so.

"(2) In determining whether reliance [is][is not] reasonable, regard shall be had, if appropriate, to:

(a) the nature of the underlying transaction that the signature was intended to support;

(b) whether the relying party has taken appropriate steps to determine the reliability of the signature;

(c) whether the relying party knew or ought to have known that the signature had been compromised or revoked;

(d) any agreement or course of dealing which the relying party has with the subscriber, or any trade usage which may be applicable;

(e) any other relevant factor."

110. Support was expressed both for and against the retention of draft article 10. In support of retention, it was pointed out that draft article 10 served a useful purpose in setting forth conduct that the relying party should follow, along the lines of a code of conduct. A further view was that, since electronic signatures were a new phenomenon and raised issues relevant to reliance that were not raised by handwritten signatures, draft article 10 could provide courts and tribunals with useful guidance. In addition, it was pointed out that, since draft article 11 focused upon certificates, draft article 10 could address types of signatures that did not rely upon certificates and assist the efforts of the Working Group to formulate rules that achieved a satisfactory degree of technology neutrality.

111. A number of views were expressed in support of the deletion of the draft article. One view was that draft article 10 introduced a new concept, that of reliance, which related both to the message and the signature, and which might raise difficult questions when confronted with the law of obligations and the need to assign risk. It was suggested, in relation to assignment of risk, that the draft article raised issues which it did not explicitly settle, and therefore was likely to lead to confusion and uncertainty. If the draft article were to be retained, its relationship to questions of risk allocation would need to be clarified.

112. Concern was expressed as to the relationship between draft articles 10 and 6. One view was that a provision dealing with the question of whether or not a signature could be relied upon was tantamount to addressing the reliability of the signature method, an issue dealt with in draft article 6. In response, it was pointed out that the focus of draft article 10 was conduct that would make reliance possible, not the reliability of a signature method within the meaning of draft article 6. Another view was that, where issues of reliance were covered by contract, these should be left to draft article 6 and the determination of what signature technique satisfied the criteria of reliability. In the case of third parties, where contract was not relevant, mere reliance would not be sufficient to establish an obligation on the part of the signature holder. Since draft article 10 did not address anything beyond the question of mere reliance, it added very little to the Uniform Rules and therefore could be deleted. It was further suggested that what was required was a provision which addressed something in addition to the reliability of the signature and this was provided in draft article 11, which addressed reliance on certificates.

113. As a matter for drafting, some support was expressed in favour of a negative formulation of draft article 10, since this would be consistent with an approach under which draft articles 9 to 12 would establish a code of conduct, without addressing the consequences of failure to

follow the conduct indicated. As a substantive point, however, it was noted that the criteria set forth in paragraph (2) were not really rules of conduct, with the possible exception of subparagraph *(b)*. While a code of conduct might be a useful means of addressing the issues set forth in draft article 10, it was pointed out that draft article 10, as currently drafted, did not achieve this aim. Another drafting suggestion was to add a further criterion to paragraph (2) to the effect that it should be ascertained whether the electronic signature was the subject of a certificate.

114. After discussion, the Working Group decided that, before reaching a final conclusion on draft article 10, it would be necessary to consider draft article 11, and the responsibilities that might attach to information certifiers under draft article 12.

Article 11. *Reliance on certificates*

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

"(1) A person [is] [is not] entitled to rely on a certificate to the extent that it [is] [is not] reasonable to do so.

"(2) In determining whether reliance [is][is not] reasonable, regard shall be had, if appropriate, to:

(a) any restrictions placed upon the certificate;

(b) whether the relying party has taken appropriate steps to determine the reliability of the certificate, including reference to a certificate revocation list where relevant;

(c) any agreement or course of dealing which the relying party has with the information certifier or subscriber or any trade usage which may be applicable;

(d) [any] [all] other relevant factor[s]."

116. At the outset of the discussion on draft article 11, concern was expressed that the emphasis of the draft article should be upon reliance on the information contained in the certificate, not on the certificate as such. Although it was acknowledged that this could be addressed in draft article 2 in the definition of "certificate", a preference for making this point expressly in the substance of draft article 11 was stated. A question was raised as to whether draft article 11 should focus upon the conduct required to establish that reliance was reasonable, or address the criteria by which the quality or reliability of a certificate could be ascertained. Support was expressed in favour of draft article 11 addressing issues of reliance on, not reliability of, the certificate.

117. Concerns were expressed that draft article 11, like draft article 10, introduced a new concept of reliance. While draft article 11 set out criteria to be followed before reliance could be determined to be reasonable, it did not address what would occur where some of those matters were not properly considered or where the certificate was relied upon, notwithstanding that it might not have been reasonable to do so. In other words, it did not address the consequences of failure to comply with what was set forth in paragraph (2). Support was expressed in favour of draft article 11 addressing the consequences for the relying party in those situations. As to the content of a provision on such consequences, two approaches were suggested. One suggestion was to include a formulation along the lines of the draft provisions quoted following paragraph 58 of document A/CN.9/WG.IV/WP.82, which would provide that, in the event of failure to follow the conduct in paragraph (2), the relying party would bear the risk that the signature was not valid as a signature. Another suggestion was that failure to follow the prescribed conduct would result in the relying party having no claim against either the information certifier or the signature holder. While support was expressed in favour of both of the above-suggested approaches, doubts were expressed as to whether rules along these lines would be appropriate in all cases. Several examples were cited in which it was suggested that the result should not be that the relying parties bore the risk of the signature being invalid simply because they did not follow the conduct set forth in draft article 11 (e.g. where the relying party failed to check a certificate revocation list but checking that list would not have revealed that the signature had been compromised). In support of that view, it was suggested that the purpose of draft article 11 was not to override contractual terms and conditions, nor was it intended to remove the ability to decide each case on its merits from the relevant court or tribunal.

118. The view was expressed that draft article 11 should not specify consequences, but should be more along the lines of a code of conduct, a view already noted in respect of draft article 10. A related view was that the negative formulation of draft article 11 was preferable because it did not create legal effect and supported the notion of a code of conduct. In support of the view that draft article 11 should establish a code of conduct, it was pointed out that different jurisdictions adopted different rules on liability, for example, on the application of comparative negligence, and it would be very difficult to reach agreement on how consequences could be addressed. A further view expressed was that, as the law of electronic commerce was not a discrete area of law, rules proposed by the Working Group to deal with concepts which already existed in national law (even if in slightly different contexts and even if the specific application of these concepts to electronic commerce issues might be uncertain) could not ignore the manner in which those concepts were treated. This was especially true in relation to issues of liability and the consequences of liability. It was suggested that the Working Group should focus upon setting forth relevant factors that would assist courts and tribunals to extend these existing concepts to electronic commerce.

119. Doubts were expressed about the use of the word "entitlement" and the appropriateness of establishing an entitlement to rely upon a certificate in draft article 11. The view was expressed that the word "entitlement" might suggest that some benefit was being conferred upon the relying party in addition to what might otherwise be applicable. To address this difficulty, an article along the following lines was proposed:

"In determining whether it was reasonable for a person to have relied on the information in a certificate, regard shall be had to: [insert paragraph 2*(a)* to *(d)*]"

120. Support was expressed in favour of the substance of the criteria set forth in paragraph (2), with a suggestion for the addition of a further factor along the lines of paragraph 2*(c)* of draft article 10, but in relation to the signature device. As a matter of drafting, it was suggested that, for reasons of completeness, reference to a suspension list, in addition to a revocation list, should be added to paragraph 2*(b)*.

121. As to the location of draft article 11 in the Uniform Rules, it was proposed that draft articles 9 and 12 should appear before draft articles 10 and 11, since those articles established the responsibilities of signature holders and information certifiers, both of which were relevant to the question of reliance and the scope of the responsibility of the relying party. A related suggestion was that draft articles 10 and 11 should be merged into a single article dealing with both signatures and signatures supported by certificates. It was pointed out, however, that this suggestion reflected a previous draft of this article, which had been separated into two articles for the reasons that different considerations applied to the concepts of reliance on signature and reliance on signatures supported by certificates (A/CN.9/WG.IV/WP.82, para. 56).

122. After discussion, the Working Group decided, in respect of both draft articles 10 and 11, that: (1) although the discussion on draft article 10 had not been completed, the secretariat should prepare a revised draft of article 10 to reflect the deliberations in the Working Group; (2) the secretariat should prepare a revised draft of article 11 to reflect (possibly as two variants or, alternatively, as two consecutive paragraphs) the proposal set out in paragraph 119 above and the two types of consequences discussed in paragraph 117 above; (3) draft articles 10 and 11 should be located in the Uniform Rules after draft article 12; and (4) draft articles 10 and 11 should not be merged on the basis of the reasons discussed in the Working Group.

Article 12. *[Responsibilities] [duties] of an information certifier*

123. The text of draft article 12 as considered by the Working Group was as follows:

"(1) [An information certifier is [obliged to [shall]] [inter alia]:

(a) act in accordance with the representations it makes with respect to its practices;

(b) take reasonable steps to ascertain the accuracy of any facts or information that the information certifier certifies in the certificate, [including the identity of the signature holder];

(c) provide reasonably accessible means which enable a relying party to ascertain:

(i) the identity of the information certifier;

(ii) that the person who is [named][identified] in the certificate holds [at the relevant time] the [private key corresponding to the public key][signature device] referred to in the certificate;

[(iii) that the keys are a functioning key pair];

(iv) the method used to identify the signature holder;

(v) any limitations on the purposes *or value* for which the signature may be used; and

(vi) whether the signature device is valid and has not been compromised;

(d) provide a means for signature holders to give notice that an enhanced electronic signature has been compromised and ensure the operation of a timely revocation service;

(e) exercise due diligence to ensure the accuracy and completeness of all material representations made by the information certifier that are relevant to issuing, suspending or revoking a certificate or which are included in the certificate;

(f) Utilize trustworthy systems, procedures and human resources in performing its services.

"Variant X

"(2) An information certifier shall be [responsible] [liable] for its failure to [fulfil the obligations [duties] in][satisfy the requirements of] paragraph (1).

"(3) Liability of the information certifier may not exceed the loss which the information certifier foresaw or ought to have foreseen at the time of its failure in the light of facts or matters which the information certifier knew or ought to have known to be possible consequences of the information certifier's failure to [fulfil the obligations [duties] in][satisfy the requirements of] paragraph (1).

"Variant Y

"(2) Subject to paragraph (3), if the damage has been caused as a result of the certificate being incorrect or defective, an information certifier shall be liable for damage suffered by either:

(a) a party who has contracted with the information certifier for the provision of a certificate; or

(b) any person who reasonably relies on a certificate issued by the information certifier.

"(3) An information certifier shall not be liable under paragraph (2):

(a) if, and to the extent, it included in the certificate a statement limiting the scope or extent of its liability to any person; or

(b) if it proves that it [was not negligent][took all reasonable measures to prevent the damage]."

General remarks

124. It was noted, at the outset, that the scope of draft article 12 should be understood as covering the activities of information certifiers only in connection with those electronic signatures that were intended to produce legal effect under draft articles 6 and 7. Other activities of information certifiers, including the possible issuance of certificates of lesser reliability were not dealt with by the Uniform Rules.

125. As a matter of drafting, it was suggested that the notion of "information certifier" might be replaced appro-

priately by the more descriptive term "supplier of certification services". It was agreed that the question might need to be further discussed in the context of draft article 2.

Title

126. It was generally agreed that the title of draft article 12 should parallel the title of draft article 9 (see above, para. 100).

Paragraph (1)

127. For reasons of consistency, it was also agreed that the opening words of paragraph (1) should mirror those of draft article 9 (1) (see above, paras. 101 and 105). A suggestion was made that the words "which enable a relying party to ascertain" should be replaced by the words "which enable a relying party to ascertain any of the following, that the information certifier is capable of disclosing". That suggestion was objected to on the grounds that the factors listed in subparagraph *(c)* did not address what the information certifier was capable of disclosing or not, but should be regarded as establishing a prescriptive list of cumulative factors to be made available in any event by the information certifier.

Subparagraph (a)

128. The substance of subparagraph *(a)* was found to be generally acceptable. As a matter of drafting, a suggestion was made that the reference to the information certifier's "practices" should be replaced by a reference to its "activities". However, it was felt that, in view of the widespread use of concepts such as that of "certification practices statement", the reference to "practices" should be maintained.

Subparagraphs (b) *and* (e)

129. The substance of both subparagraphs was found to be generally acceptable. In view of the similarities in their contents, it was agreed that they should be merged into one subparagraph, which would read along the following lines: "exercise due diligence to ensure the accuracy and completeness of all material representations made by the information certifier that are relevant to the life-cycle of the certificate, or which are certified in the certificate".

Subparagraph (c)

130. The substance of subparagraphs *(c)*(i) and *(c)*(iv) to (vi) was found to be generally acceptable.

131. It was noted that subparagraph *(c)*(ii) referred both to a "key pair" and to a "signature device". To reflect the technology-neutral approach taken in the Uniform Rules, the Working Group agreed that a technology-neutral formulation such as "signature device" or "signature creation device" should be used as an alternative to the words "key pair", since "key pair" referred specifically to digital signatures. Use of the phrase "key pair" in relation to the definition of "certificate" might be appropriate in situations where certificates were only used in a digital signature context.

132. With respect to subparagraph *(c)*(ii), a suggestion of a drafting nature was that, consistent with the approach taken in the context of draft article 6 (see above, para. 80), the word "identified" should be used instead of the word "named". Under that approach, the concept of identity was to be interpreted more broadly than a mere reference to the name of the signature holder, since it might refer to other significant characteristics, such as position or authority, either in combination with a name or without reference to the name (see A/CN.9/WG.IV/WP.82, para. 29). After discussion, the Working Group agreed that subparagraph *(c)*(ii) should read along the following lines: "that the person who is identified in the certificate holds, at the relevant time, the signature device referred to in the certificate".

133. It was generally agreed that subparagraph *(c)*(iii) should be deleted. If the public key referred to in the certificate corresponded to the private key held by the signature holder and there was, therefore, a mathematical correspondence between the two keys, it was not clear what additional functionality would be achieved by a requirement that the key pair be "a functioning key pair". It was also uncertain whether the information certifier could provide information, in addition to what was required by paragraph *(c)*(ii), that would indicate that additional functionality.

Subparagraphs (d) *and* (f)

134. The substance of subparagraphs *(d)* and *(f)* was found to be generally acceptable.

Proposals for additional provisions

135. In the context of the discussion of subparagraph *(c)*, the view was expressed that draft article 12 should establish an additional rule setting out the minimum contents of a certificate (see A/CN.9/WG.IV/WP.82, para. 61). It was suggested that such a rule might be based on elements of subparagraph *(c)* and on paragraph (3)*(a)* of variant Y along the following lines:

"A certificate shall state

(a) the identity of the information certifier;

(b) that the person who is identified in the certificate holds, at the relevant time, the signature device referred to in the certificate;

(c) that the signature device was effective at or before the date when the certificate was issued;

(d) any limitations on the purposes or value for which the certificate may be used; and

(e) any limitation on the scope or extent of liability which the information certifier accepts to any person".

136. Another proposal was made, in relation to a proposal made earlier in connection with draft article 13 to the effect that the characteristics of an information certifier as described in draft article 13 should not be taken into account only in respect of foreign entities but should equally apply to domestic information certifiers (see above, paras. 30 and 35). Accordingly, it was suggested that a subparagraph *(g)*

should be added at the end of paragraph (1) along the following lines:

"*(g)* In determining whether and the extent to which any systems, procedures and human resources are trustworthy for the purposes of subparagraph *(f)*, regard shall be had to the following factors: [subparagraphs *(a)* to *(h)* of draft article 13(4), Variant B]".

137. Those two proposals were met with considerable interest. It was agreed that the issues they raised might need to be further discussed at a future session on the basis of a revised draft of paragraph (1) to be prepared by the secretariat to reflect the above discussion.

Paragraph (2)

138. While the desirability of establishing basic rules regarding liability of information certifiers was noted, it was widely felt that consensus might be difficult to achieve in respect of what those rules might be. For reasons already expressed in the context of draft article 9 (see above, paras. 107 and 108), a strong body of opinion was that the Uniform Rules could do little more than adopting paragraph (2) of Variant X, thus stating a general principle that failure by the information certifier to comply with the requirements of paragraph (1) should entail liability. As to precisely what that liability might be (e.g. contractual or tortious liability, liability for negligence or strict liability), no attempt should be made in the Uniform Rules to establish any provision that might conflict, or otherwise interfere, with existing legal doctrines regarding liability under applicable law.

139. An equally strong feeling was that the authors of the Uniform Rules should not miss the opportunity of establishing guiding principles and minimum standards as to liability and allocation of risk in the field of electronic signatures. Such guidance was needed by legislators and courts that would be confronted with the practical issues of liability in electronic commerce. Internationally recognized liability standards were also needed by practitioners of electronic signatures, including information certifiers themselves. Examples were given of national laws specifically geared to electronic signatures, which dealt with the issue of liability of information certifiers simply by establishing that contractual clauses limiting the liability of such information certifiers should be treated as null and void. In the absence of minimal harmonization at the international level, national laws applicable through conflicts rules might thus impose extremely harsh standards that could potentially affect the growth and the global availability of electronic commerce techniques.

140. Various suggestions were made as to how minimal liability provisions could be drafted. One suggestion was to adopt paragraph (3) of Variant X. However, while it was generally agreed that the liability of the information certifier might need to be treated differently from the liability of the signature holder, doubts were expressed as to whether the criterion of foreseeability was more likely to achieve consensus in draft article 12 than it had been in the context of draft article 9 (see above, para. 107). Another suggestion was that the Uniform Rules, without interfering with the operation of domestic law, might provide a list of factors to be taken into consideration when applying domestic law to information certifiers. Wording along the following lines was suggested:

"In assessing the loss, regard shall be had to the following factors:

(a) the cost of obtaining the certificate;

(b) the nature of the information being certified;

(c) the existence and extent of any limitation on the purpose for which the certificate may be used;

(d) the existence of any statement limiting the scope or extent of the liability of the information certifier; and

(e) any contributory conduct by the relying party."

141. The suggestion was met with considerable interest. It was stated that such wording might provide useful guidance, while preserving the necessary flexibility to avoid interfering with the operation of local law regarding, for example, a differentiated measure of damages, or a differentiated assessment of contributory negligence, according to whether liability was in contract or in tort.

142. For lack of sufficient time, the Working Group did not pursue the discussion and decided that it should be resumed at its next session. The secretariat was requested to prepare a revised draft of paragraph (2) taking into account the above discussion. It was noted that, in accordance with the decision made by the Commission at its thirty-second session, the thirty-sixth session of the Working Group would be held in New York from 14 to 25 February 2000.[5]

[5]Ibid., para. 434.

B. Working paper submitted to the Working Group on Electronic Commerce at its thirty-fifth session: draft Uniform Rules on Electronic Signatures: note by the secretariat (A/CN.9/WG.IV/WP.82) [Original: English]

CONTENTS

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 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). 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 no firm decision as to the form and content of such work had been reached, the Working Group 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 and 157).

[1] *Official Records of the General Assembly, Fifty-first Session, Supplement No. 17* (A/51/17), paras. 223 and 224.

3. The Commission 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"). 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 UNCITRAL Model Law on Electronic Commerce (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.[2]

4. The Working Group began the preparation of the Uniform Rules at its thirty-second session on the basis of a note prepared by the secretariat (A/CN.9/WG.IV/WP.73).

5. At its thirty-first session (1998), the Commission had before it the report of the Working Group on the work of its thirty-second session (A/CN.9/446). 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 that arose 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 realized 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 thirtieth session as to the feasibility of preparing such Uniform Rules and expressed its confidence that more progress could be accomplished by the Working Group at its thirty-third session 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.[3]

6. At its thirty-second session (1999), the Commission had before it the report of the Working Group on the work of its thirty-third (July 1998) and thirty-fourth (February 1999) sessions (A/CN.9/454 and 457). The Commission expressed its appreciation for the efforts accomplished by the Working Group in its preparation of draft uniform rules on electronic signatures. While it was generally agreed that significant progress had been made at those sessions in the understanding of the legal issues of electronic signatures, it was also felt that the Working Group had been faced with difficulties in the building of a consensus as to the legislative policy on which the uniform rules should be based.

7. A view was expressed that the approach currently taken by the Working Group did not sufficiently reflect the business need for flexibility in the use of electronic signatures and other authentication techniques. As currently envisaged by the Working Group, the Uniform Rules placed excessive emphasis on digital signature techniques and, within the sphere of digital signatures, on a specific application involving third-party certification. Accordingly, it was suggested that work on electronic signatures by the Working Group should either be limited to the legal issues of cross-border certification or be postponed altogether until market practices were better established. A related view expressed was that, for the purposes of international trade, most of the legal issues arising from the use of electronic signatures had already been solved in the UNCITRAL Model Law on Electronic Commerce. While regulation dealing with certain uses of electronic signatures might be needed outside the scope of commercial law, the Working Group should not become involved in any such regulatory activity.

8. The widely prevailing view was that the Working Group should pursue its task on the basis of its original mandate (see above, para. 3). With respect to the need for uniform rules on electronic signatures, it was explained that, in many countries, guidance from UNCITRAL was expected by governmental and legislative authorities that were in the process of preparing legislation on electronic signature issues, including the establishment of public key infrastructures (PKI) or other projects on closely related matters (see A/CN.9/457, para. 16). As to the decision made by the Working Group to focus on PKI issues and PKI terminology, it was recalled that the interplay of relationships between three distinct types of parties (i.e. key holders, certification authorities and relying parties) corresponded to one possible PKI model, but that other models were conceivable, e.g. where no independent certification authority was involved. One of the main benefits to be drawn from focusing on PKI issues was to facilitate the structuring of the Uniform Rules by reference to three functions (or roles) with respect to key pairs, namely, the key issuer (or subscriber) function, the certification function, and the relying function. It was generally agreed that those three functions were common to all PKI models. It was also agreed that those three functions should be dealt with irrespective of whether they were in fact served by three separate entities or whether two of those functions were served by the same person (e.g. where the certification authority was also a relying party). In addition, it was widely felt that focusing on the functions typical of PKI and not on any specific model might make it easier to develop a fully media-neutral rule at a later stage (ibid., para. 68).

[2]Ibid., *Fifty-second Session, Supplement No. 17* (A/52/17), paras. 249-251.

[3]Ibid., *Fifty-third Session, Supplement No. 17* (A/53/17), para. 208.

9. After discussion, the Commission reaffirmed its earlier decisions as to the feasibility of preparing such uniform rules (see above, paras. 3 and 5) and expressed its confidence that more progress could be accomplished by the Working Group at its forthcoming sessions.

10. This note contains the revised draft provisions prepared pursuant to the deliberations and decisions of the Working Group and also pursuant to the deliberations and decisions of the Commission at its thirty-second session, as reproduced above. They are intended to reflect the decisions made by the Working Group at its thirty-fourth session. Newly revised provisions are indicated by italic text.

11. In line with the applicable instructions relating to the stricter control and limitation of United Nations documents, the explanatory remarks to the draft provisions have been kept as brief as possible. Additional explanations will be provided orally at the session.

References to national legislation and other texts

12. For information and comparison, references to national legislation and other texts are included under this heading in boxed text for a number of articles. References to national legislation have been included on the basis of those statutes of which the secretariat is aware and which are available for reference. References to other texts are included on the basis that they were concluded by international organizations or are widely known and publicly available. Abbreviations refer to the following legislation and texts:

Germany:	Digital Signature Law 1997 (Article 3, Information and Communication Services Act, approved 13/6/97; in force 1/8/97);
Illinois:	USA, Electronic Commerce Security Act 1998, (1997 Illinois House Bill 3180; 5 Ill. Comp. Stat. 175, enacted August 1998);
Minnesota:	USA, Electronic Authentication Act (Minnesota Statutes §325, enacted May 1997);
Missouri:	USA, Digital Signature Act, 1998 (1998 SB 680, enacted July 1998);
Singapore:	Electronic Transactions Act 1998, Act No. 25 of 1998.
ABA Guidelines:	American Bar Association, Science and Technology Section, "Digital Signature Guidelines", 1996;
EC Draft Directive:	Draft Directive of the European Parliament and of the Council on a common framework for electronic signatures, 1999 (7015/99);
GUIDEC:	International Chamber of Commerce, "General Usage for International Digitally Ensured Commerce", 1997.

I. GENERAL REMARKS

13. 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 legislative 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.

14. 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.

15. 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).

16. 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. This draft of the Uniform Rules has been prepared on the basis that they will constitute a separate legal instrument. Two newly added articles reflecting provisions contained in the Model Law have been included—articles 1 (Sphere of application) and 4 (Interpretation). Transactions involving consumers have not been specifically excluded from the sphere of application of the Uniform Rules, but the footnote from the Model Law has been included in the text of draft article 1 to clarify that the Uniform Rules are not intended to override any provision of national law dealing with consumer protection issues.

17. 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 electronic communication by establishing a security framework and by giving written and electronic messages equal status as regards their legal effect.

18. At the thirty-third session of the Working Group, doubts were expressed as to the appropriateness of using the terms "enhanced" or "secure" to describe signature techniques that were capable of providing a higher degree

of reliability than "electronic signatures" in general (A/CN.9/454, para. 29). The Working Group concluded that, in the absence of a more appropriate term, "enhanced" should be retained. At the thirty-fourth session (A/CN.9/457, para. 39), it was suggested that the definition of "enhanced electronic signature" might need to be reconsidered, together with the general architecture of the Uniform Rules, once the purpose of dealing with two categories of electronic signatures had been clarified, particularly as regards the legal effects of both types of electronic signatures. It was suggested that dealing with enhanced electronic signatures offering a high degree of reliability was justified only if the Uniform Rules were to provide a functional equivalent to specific uses of handwritten signatures. Since this was likely to prove particularly difficult at the international level and be of limited relevance to international commercial transactions, the additional benefit to be expected from using an "enhanced electronic signature" as opposed to a mere "electronic signature" might need to be clarified.

19. In view of this discussion of the need for a category of "enhanced electronic signatures", this revised draft of the Uniform Rules includes an alternative approach for discussion by the Working Group. The definition of "enhanced electronic signature" in draft article 2*(b)* has been placed in square brackets. Remarks addressing possible amendment of the definition are included under article 2. Draft articles 6, 7 and 8 include the relevant parts of that definition as alternative substantive provisions. The purpose of this alternative approach is to assist the Working Group in deciding whether the references to both electronic and enhanced electronic signatures should be eliminated so that the Uniform Rules would deal only with a single category of electronic signature. Remarks addressing specific proposals are dealt with under respective articles.

20. This revised draft of the Uniform Rules extends their application beyond the situation where there are legal form requirements or where the law provides for consequences in the absence of certain conditions, such as signature or original. As such, the scope of the Uniform Rules is potentially wider than that of the Model Law, although draft article 6 does include the form requirement of article 7 of the Model Law. The Working Group may wish to consider this broader application for the Uniform Rules.

II. DRAFT ARTICLES ON ELECTRONIC SIGNATURES

Article 1. *Sphere of application*

These Rules apply to electronic signatures used in the context of commercial relationships and do not override any law intended for the protection of consumers.*

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

Reference to UNCITRAL documents

A/CN.9/457, paras. 53-64.

Remarks

21. Draft article 1 was originally proposed at the thirty-fourth session of the Working Group as paragraph (1) to an article dealing with party autonomy (draft article E, A/CN.9/457, paras. 55, 60). As this provision more properly deals with issues of scope of the Uniform Rules it has been included in this draft as a separate article under the heading "Sphere of application". As agreed by the Working Group (A/CN.9/457, para. 64), draft article 1 includes a footnote which repeats the definition of "commercial" in article 1 of the Model Law on Electronic Commerce and adopts the wording of footnote** to the Model Law on the question of consumers. The words "electronic signatures used in the context of" have been added to the article to define more precisely the subject matter of the Uniform Rules.

Article 2. *Definitions*

For the purposes of these Rules:

(a) "Electronic signature" means [data in electronic form in, affixed to, or logically associated with, a data message, and] *[any method in relation to a data message]* that may be used to identify the signature holder in relation to the data message and indicate the signature holder's approval of the information contained in the data message;

[*(b) "Enhanced electronic signature" means an electronic signature in respect of which it can be shown, through the use of a [security procedure] [method], that the signature:*

(i) is unique to the signature holder [for the purpose for][within the context in] which it is used;

(ii) was created and affixed to the data message by the signature holder or using a means under the sole control of the signature holder *[and not by any other person];*

[*(iii) was created and is linked to the data message to which it relates in a manner which provides reliable assurance as to the integrity of the message";]*]

(c) "Certificate" means a data message or other record which is issued by an information certifier and which purports to *ascertain* the identity of a person or entity who holds a particular [key pair] *[signature device]*;

(d) "Data message" means information generated, sent, received or stored by electronic, optical or similar means including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy;

(e) "Signature holder" *[device holder] [key holder] [subscriber] [signature device holder] [signer] [signatory]* means a person by whom, or on whose behalf, an enhanced electronic signature can be created and affixed to a data message;

(f) "Information certifier" means a person or entity which, in the course of its business, engages in [providing identification services] [certifying information] which [are][is] used to support the use of [enhanced] electronic signatures.

References to UNCITRAL documents

A/CN.9/457, paras. 22-47; 66-67; 89; 109;
A/CN.9/WG.IV/WP.80, paras. 7-10;
A/CN.9/WG.IV/WP.79, para. 21;
A/CN.9/454, para. 20;
A/CN.9/WG.IV/WP.76, paras. 16-20;
A/CN.9/446, paras. 27-46 (draft article 1), 62-70 (draft article 4), 113-131 (draft article 8), 132 and 133 (draft article 9);
A/CN.9/WG.IV/WP.73, paras. 16-27, 37-38, 50-57, and 58-60;
A/CN.9/437, paras. 29-50 and 90-113 (draft articles A, B and C); and A/CN.9/WG.IV/WP.71, paras. 52-60.

Remarks

Definition of "electronic signature"

22. The definition of electronic signature has been revised in accordance with the decision of the Working Group at its thirty-fourth session (A/CN.9/457, paras. 23-32). The words in square brackets "[any method in relation to a data message]" are included in order to align the language of the definition in the Uniform Rules with that of article 7 of the Model Law.

Definition of "enhanced electronic signature"

23. In accordance with the decision of the Working Group at its thirty-fourth session (A/CN.9/457, para. 39), the definition of "enhanced electronic signature" has been revised to include in subparagraph *(b)*(iii) the language in square brackets as a necessary link between the enhanced signature on the data message and the information contained in the data message, in the form of an integrity function. The Working Group may wish to consider whether integrity should be included as an integral part of the definition of an enhanced electronic signature or whether, as a concept, it is more relevant to the idea of an original, as in article 8 of the Model Law and draft article 7 of these Uniform Rules. The wording previously included as subparagraph (ii), "can be used to identify objectively the signature holder in relation to the data message" has been omitted from this revision on the basis that it is part of the definition of an "electronic signature" in subparagraph *(a)*.

24. In the opening words of subparagraph *(b)*, the reference to use of a "method", as an alternative to the use of a "security procedure" has been included to more closely align the terminology with that of the Model Law.

25. In subparagraph *(b)*(ii) the words "and not by any other person" have been placed in square brackets as their inclusion raises a number of issues. First, including those words in the definition of enhanced electronic signature may suggest that any signature that is not created and affixed by the signature holder (and therefore potentially unauthorized) is not an enhanced electronic signature. This interpretation may have the effect of excluding such signatures from the scope of some articles of the Uniform Rules including, for example, draft articles 8, 9 and 10. In particular, the application of those parts of draft article 9 which deal with responsibility for compromise of signature devices could be uncertain.

26. Secondly, the inclusion of those words would require that, in order for a security procedure or method to be an enhanced electronic signature, it must be able to show that the signature was actually created and affixed by the signature holder. Since for some technologies this may not be possible, including such a requirement may suggest the need for the use of a personal identifier, such as the use of biometrics or some other such technique, in conjunction with the use of the signature device.

27. A further issue which the Working Group may wish to consider in the context of subparagraph *(b)*(ii) is the relationship between the requirement for "sole control" and paragraph (2) of draft article 9 which provides for joint control. This issue also arises in relation to the definition of "signature holder" below.

28. In subparagraph *(b)*(iii) the phrase "reasonable assurance" has been changed to "reliable assurance" to maintain consistency with the terminology of article 8 of the Model Law.

Definition of "certificate"

29. A definition of "certificate" has been included in the Uniform Rules for reasons of completeness. This definition is based upon the definition in A/CN.9/WG.IV/WP.79 of an "identity certificate", although no longer described in these Uniform Rules as an "identity certificate". The Working Group may wish to consider whether the words in square brackets, "or other significant characteristics", can be deleted for the following reason. The concept of identity may be more than a reference to the name of the signature holder, and may refer to other significant characteristics, such as position or authority, either in combination with a name or without reference to the name. On that basis, it would not be necessary to distinguish between identity and other significant characteristics, nor to limit the Uniform Rules to those situations in which only identity certificates which named the signature holder were used. For an alternative view of the meaning of "identity" see "Background Paper on Electronic Authentication Technologies and Issues", Joint OECD-Private Sector Workshop on Electronic Authentication, California, 2-4 June 1999, pp. 6-9.

30. The Working Group may wish to consider whether the words "confirm the identity" is appropriate, on the basis that the certificate may not actually *confirm* the identity of the signature holder, but rather identify the signature holder by following certain procedures and certify that that identity is

linked to the signature device or public key listed in the certificate. To ensure that the Uniform Rules are technology neutral, the Working Group may also wish to consider the use of a technology neutral formulation such as "signature device" as an alternative to the words "key pair", since "key pair" refers specifically to digital signatures. Use of the phrase "key pair" in relation to the definition of "certificate" may be appropriate in situations where certificates are only used in a digital signature context.

Definition of "data message"

31. A definition of "data message" has been included in the draft Uniform Rules for reasons of completeness. The Working Group may wish to consider the need for inclusion of this definition in the context of the relationship of the Uniform Rules to the Model Law.

Definition of "signature holder"

32. The Working Group did not conclude its discussion on the definition of "signature holder" at its thirty-fourth session (A/CN.9/457, para. 47). The revised definition now includes, in square brackets, a number of terms which the Working Group considered may be more appropriate than "signature holder". This definition may need to be reviewed in the context of subparagraph *(b)*(ii) of the definition of "enhanced electronic signature" above and draft article 9(2), as noted at para. 27.

Definition of "information certifier"

33. This definition was not considered by the Working Group at its previous session and remains unchanged. However, in view of earlier discussions (A/CN.9/457, para. 109), the Working Group may wish to consider whether the words "in the course of its business" in the definition of "information certifier" should be interpreted as implying that certification-related activities should be the exclusive business activity of an information certifier or whether, in order to embrace situations such as those where credit card companies would issue certificates, the issue of certificates as an incidental part of the business of an entity should also be covered.

REFERENCES TO NATIONAL LEGISLATION AND OTHER TEXTS

ABA Guidelines

Part 1. Definitions

1.5. Certificate

A message which at least

(1) identifies the certification authority issuing it;

(2) names or identifies its subscriber;

(3) contains the subscriber's public key;

(4) identifies the operational period; and

(5) is digitally signed by the certification authority issuing it.

1.6. Certification authority

A person who issues a certificate.

1.27. Relying party

A person who has received a certificate and a digital signature verifiable with reference to a public key listed in the certificate, and is in a position to rely on them.

1.30. Signer

A person who creates a digital signature for a message.

1.31. Subscriber

A person who

(1) is the subject named or identified in a certificate issued to such person; and

(2) holds a private key that corresponds to a public key listed in that certificate.

EC Draft Directive

Article 2

Definitions

For the purpose of this Directive:

1. "electronic signature" means data in electronic form attached to, or logically associated with, other electronic data and which serves as a method of authentication.

1a. "advanced electronic signature" means an electronic signature which meets the following requirements:

(a) it is uniquely linked to the signatory;

(b) it is capable of identifying the signatory;

(c) it is created using means that the signatory can maintain under his sole control; and

(d) it is linked to the data to which it relates in such a manner that any subsequent change of the data is detectable.

2. "signatory" means a person who holds a signature creation device and acts either on their own behalf or on the behalf of the person or the entity they represent.

3. "signature creation data" means unique data such as codes or private cryptographic keys, which is used by the signatory in creating an electronic signature.

3a. "signature creation device" means a configured software or hardware device to implement the signature creation data.

3b. "secure signature creation device" is a signature creation device that meets the requirements of annex III.

4. "signature verification data" means data, such as codes or public cryptographic keys, which is used in verifying the electronic signature.

4a. "signature verification device" means a configured software or hardware device to implement the signature verification data.

4b. "certificate" means an electronic attestation which links a signature verification data to a person, and confirms the identity of that person.

5. [...]

6. "certification service provider" means a person who or entity which issues certificates or provides other services related to electronic signatures.

Germany

§2 Definitions

(1) A digital signature within the meaning of this law is a seal on digital data created with a private signature key, which seal allows, by use of the associated public key to which a signature key certificate of a certifier or of the Authority under §3 is affixed, the owner of the signature key and the unforged character of the data to be ascertained.

(2) A certifier within the meaning of this law is a natural or legal person which attests to the attribution of public signature keys to natural persons and holds a licence therefor under §4.

(3) A certificate within the meaning of this law is a digital attestation concerning the attribution of a public signature key to a natural person to which a digital signature is affixed (signature key certificate), or a special digital attestation which refers unmistakably to a signature key certificate and contains further information (attribute certificate).

GUIDEC

VI. Glossary of terms

2. Certificate

A message ensured by a person, which message attests to the accuracy of facts material to the legal efficacy of the act of another person.

4. Certifier

A person who issues a certificate, and thereby attests to the accuracy of a fact material to the legal efficacy of the act of another person.

12. Public key certificate

A certificate identifying a public key to its subscriber, corresponding to a private key held by that subscriber.

14. Subscriber

A person who is the subject of a certificate.

Illinois

Article 5. Electronic records and signature generally

Section 5-105. Definitions

"Certificate" means a record that at a minimum: *(a)* identifies the certification authority issuing it, *(b)* names or otherwise identifies its subscriber, or a device or electronic agent under the control of the subscriber; *(c)* contains a public key that corresponds to a private key under the control of the subscriber; *(d)* specifies its operational period; and *(e)* is digitally signed by the certification authority issuing it.

"Certification authority" means a person who authorizes and causes the issuance of a certificate.

"Electronic signature" means a signature in electronic form attached to or logically associated with an electronic record.

"Signature device" means unique information, such as codes, algorithms, letters, numbers, private keys, or personal identification numbers (PINS), or a uniquely configured physical device, that is required, alone or in conjunction with other information or devices, in order to create an electronic signature attributable to a specific person.

Singapore

Part 1. Section 2. Interpretation

"certificate" means a record issued for the purpose of supporting digital signatures which purports to confirm the identity or other significant characteristics of the person who holds a particular key pair;

"certification authority" means a person who or an organization that issues a certificate;

"electronic signature" means any letters, characters, numbers or other symbols in digital form attached to or logically associated with an electronic record, and executed or adopted with the intention of authenticating or approving the electronic record;

"key pair", in an asymmetric cryptosystem, means a private key and its mathematically related public key, having the property that the public key can verify a digital signature that the private key creates;

"private key" means the key of a key pair used to create a digital signature;

"public key" means the key of a key pair used to verify a digital signature;

"subscriber" means a person who is the subject named or identified in a certificate issued to him and who holds a private key that corresponds to a public key listed in that certificate.

Article 3. *[Non-discrimination] [Technology neutrality]*

[None of the provisions of these Rules shall be applied] [The provisions of these Rules shall not be applied] so as to exclude, restrict, or deprive of legal effect any method [of signature] that satisfies the requirements of [article 7 of the UNCITRAL Model Law on Electronic Commerce].

Reference to UNCITRAL documents

A/CN.9/457, paras. 53-64.

Remarks

34. Draft article 3 was originally proposed at the thirty-fourth session of the Working Group as paragraph (3) to an article dealing with party autonomy (draft article E, A/CN.9/457, paras. 55, 60). As paragraph (3) dealt with the issues of non-discrimination and technology neutrality, rather than party autonomy, it has been included in this draft as a separate article under the alternative headings of "Non-discrimination" and "Technology neutrality". The words "exclude, restrict or deprive of legal effect" have replaced the original words "exclude, restrict or discriminate against" to more precisely describe the purpose and object of this provision. The reference to article 7 of the Model Law on Electronic Commerce would be a reference to that Model Law as enacted in national law.

Article 4. *Interpretation*

(1) In the interpretation of these Uniform Rules, regard is to be had to their international origin and to the need to promote uniformity in their application and the observance of good faith in electronic commerce.

(2) Questions concerning matters governed by these Uniform Rules which are not expressly settled in them are to be settled in conformity with the general principles on which these Uniform Rules are based.

Remarks

35. Draft article 4 repeats article 3 of the Model Law on Electronic Commerce, with addition of the words "in electronic commerce", and is included here for reasons of completeness. The Working Group may wish to consider the question of whether the Uniform Rules should now be completed as a text which does not form part of the Model Law, although retaining a clear link to the Model Law. Should the Working Group so decide, article 4 may provide guidance to interpretation of the Uniform Rules by courts and other national or local authorities. The expected effect of article 4 would be to promote interpretation of the uniform text, once incorporated in local legislation, by reference to its international character and origins, rather than by reference only to the concepts of local law.

Article 5. *Variation by agreement*

Variant A

[By agreement, whether express or implied, parties are free to derogate from or vary any aspect of these Rules,] [Any aspect of these Rules may be derogated from or varied by agreement, whether express or implied,] except to the extent such derogation or variation would adversely affect rights of third parties.

Variant B

(1) These Rules do not affect any right that may exist to modify by agreement any rule of law referred to in articles 6 and 7.

(2) Any aspect of articles 9 to 12 of these Rules may be derogated from or varied by agreement, whether express or implied, except to the extent that such derogation or variation would adversely affect rights of third parties.

Reference to UNCITRAL documents

A/CN.9/457, paras. 53-64.

Remarks

36. Variant A of draft article 5 reflects the decision of the Working Group at its thirty-fourth session to include, for future discussion, a provision ensuring the freedom of the parties to agree among themselves that they could derogate from or vary the provisions of these Rules, for the purposes only of transactions between the agreeing parties. Such agreement, however, cannot affect the rights of parties not party to that agreement, that is, third parties. This autonomy provision relates only to these Rules, and is not intended to affect ordre public or mandatory laws applicable to contracts, such as provisions relating to unconscionable contracts.

37. Variant B recognizes that the provisions of draft articles 6 and 7 of the Uniform Rules, which are based on articles 7 and 8 of the Model Law, include references to requirements of law which may be mandatory requirements of national law and not subject to modification by agreement. Paragraph (1) allows for variation by agreement where such mandatory requirements of national law may be so modified. As such, it repeats the wording of article 4(2) of the Model Law, which deals with the same question.

38. Paragraph (2) of Variant B preserves complete party autonomy with respect to draft articles 9 to 12. This provision is drafted on the basis that draft articles 9 to 12 would be rules of substantive law that would apply in the absence of agreement to derogate from or vary the application of these provisions as between contracting parties. Parties would be free to modify or opt out of these provisions. Paragraph (2) is intended to ensure that any such agreement should not operate to the detriment of third parties, but is not intended to have the effect of invalidating any part of the agreement between the parties.

39. Provisions dealing with cross-border recognition would not be subject to variation by agreement, except as specifically provided in those provisions.

40. The Working Group may wish to consider the formulation of draft article 5 and the issues it raises in respect of the satisfaction of what may be mandatory requirements of law in draft articles 6 and 7. The Working Group may also

wish to consider how the principle of party autonomy should apply to draft articles 9 to 12. The provision could establish, for example, default rules which apply in the absence of contrary agreement between contracting parties ("opt out") or could establish rules which parties can agree to apply ("opt in").

General remarks regarding draft articles 6-8

41. In the context of a discussion at its thirty-fourth session of the scope of the Uniform Rules (A/CN.9/457, paras. 48-52), the Working Group decided to focus upon rules for technologies which were currently being used in commercial transactions, such as digital techniques within a public key infrastructure (PKI). Accordingly, it was agreed that the Working Group should focus its discussion on draft articles F to H (in this draft, articles 9 to 12) in the context of PKI. Discussion on draft articles A to D (in this draft, articles 2, 6, 7 and 8) was deferred until a later time when articles F to H had been reviewed. It was pointed out that draft article B (in this revision, article 6—Compliance with requirements for signature), in particular, might serve an important function in defining the scope of application of articles F to H. In addition, it was suggested that article E (in this draft, article 5—Variation by agreement), which dealt with the principle of party autonomy, would be important to any consideration of the obligations of the parties in articles F to H.

Article 6. *[Compliance with requirements for signature] [Presumption of signing]*

Variant A

(1) Where, in relation to a data message, an enhanced electronic signature is used, it is presumed that the data message is signed.

(2) Where the law requires a signature of a person, that requirement is met in relation to a data message if an electronic signature is used which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

[(3) Where the law requires a signature of a person, that requirement is met in relation to a data message if an enhanced electronic signature is used.]

(4) Paragraphs (2) and (3) apply whether the requirement referred to therein is in the form of an obligation or whether the law simply provides consequences for the absence of a signature.

(5) The provisions of this article do not apply to the following: [...].

Variant B

(1) Where, in relation to a data message, [a method] [an electronic signature] is used which:

(a) is unique to the signature holder [for the purpose for][within the context in] which it is used;

[*(b)* can be used to objectively identify the signature holder in relation to the data message; and]

(c) was created and affixed to the data message by the signature holder or using a means under the sole control of the signature holder *[and not by any other person]*;

it is presumed that the data message is signed.

(2) Where the law requires a signature of a person, that requirement is met in relation to a data message if an electronic signature is used which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

(3) Paragraph (2) applies whether the requirement referred to therein is in the form of an obligation or whether the law simply provides consequences for the absence of a signature.

(4) The provisions of this article do not apply to the following: [...].

References to UNCITRAL documents

A/CN.9/457, paras. 48-52;
A/CN.9/WG.IV/WP.80, paras. 11-12.

Remarks

Variant A

42. Variant A establishes that where an enhanced electronic signature is used in relation to a data message, the data message can be presumed to be signed. Paragraph (2) restates the principle of article 7 of the Model Law that an electronic signature can satisfy a requirement of law for a signature, provided that it meets certain conditions of reliability. The Working Group will recall that paragraph 58 of the Guide to Enactment of the Model Law sets out factors that may be taken into account in determining the appropriate level of reliability. Paragraph (3), which provides that an enhanced electronic signature meets those conditions and establishes a shortcut to satisfaction of the requirements of article 7 of the Model Law, has been included in this draft in square brackets. The Working Group may wish to consider whether this provision is still necessary in view of paragraph (1).

Variant B

43. The purpose of Variant B is to establish a presumption of signing and satisfaction of a requirement of law for a signature in the context of a single category of electronic signature. Accordingly, it makes no reference to "enhanced electronic signature". Paragraph (1) of Variant B establishes that where a method is used in relation to a data message and that method satisfies certain requirements, the data message can be presumed to be signed. That method is required to satisfy the conditions set forth in the definition of "enhanced electronic signature" in draft article 2*(b)*, with the exception of the reference to integrity in subparagraph *(b)*(iii). Paragraph (1)*(b)* appears in square brackets, as it would be required only if the opening words of paragraph (1) refer to "a method" rather than to "an electronic signature".

44. The Working Group may wish to consider whether these Rules should be limited in their application to situations where there are legal form requirements or where the law provides for consequences in the absence of certain conditions, such as writing or a signature. It should be recalled that what is meant by form requirements was discussed in the preparation of the Model Law. Paragraph 68 of the Guide to Enactment of the Model Law notes that the use of the phrase "the law" in the Model Law is to be understood as encompassing not only statutory or regulatory law, but also judicially-created law and other procedural law. Thus the phrase "the law" also covers rules of evidence. Where the law does not stipulate a requirement for a particular condition, but provides for consequences in the absence of the condition, for example writing or signature, this is also to be included within the concept of "the law" as used in the Model Law.

REFERENCES TO NATIONAL LEGISLATION AND OTHER TEXTS

Singapore

Part V. Secure electronic records and signatures

Secure electronic signature

17. If, through the application of a prescribed security procedure or a commercially reasonable security procedure agreed to by the parties involved, it can be verified that an electronic signature was, at the time it was made:

(a) unique to the person using it;

(b) capable of identifying such person;

(c) created in a manner or using a means under the sole control of the person using it; and

(d) linked to the electronic record to which it relates in a manner such that if the record was changed the electronic signature would be invalidated;

such signature shall be treated as a secure electronic signature.

Presumptions relating to secure electronic records and signatures

18. [...]

(2) In any proceedings involving a secure electronic signature, it shall be presumed, unless evidence to the contrary is adduced, that:

(a) the secure electronic signature is the signature of the person to whom it correlates; and

(b) the secure electronic signature was affixed by that person with the intention of signing or approving the electronic record.

Article 7. *[Presumption of original]*

(1) Where, in relation to a data message, [an enhanced electronic signature is used] [an electronic signature [a method] is used which provides a reliable assurance as to the integrity of the information from the time when it was first generated in its final form, as a data message or otherwise], it is presumed that the data message is an original.

(2) The provisions of this article do not apply to the following: [...].

References to UNCITRAL documents

A/CN.9/457, paras. 48-52;
A/CN.9/WG.IV/WP.80, paras. 13 and 14.

Remarks

45. The purpose of draft article 7 is to confirm the connection with article 8 of the Model Law and the requirement of integrity. Paragraph (1) sets out two alternatives. The first provides that the use of an enhanced electronic signature, as defined in draft article 2*(b)*, will establish a presumption that the data message is an original. The second alternative is that where an electronic signature or a method is used which provides a reliable assurance of integrity, the data message can be presumed to be an original. Although an original form does not always require a signature, the use of a form of electronic signature, whether enhanced or not, may be used to verify the integrity of the data message or record.

Article 8. *Determination of [enhanced] electronic signature*

(1) *[The organ or authority specified by the enacting State as competent]* may determine [that an electronic signature is an enhanced electronic signature] [which [methods][electronic signatures] satisfy the requirements of articles 6 and 7].

(2) Any determination made under paragraph (1) should be consistent with recognized international standards.

References to UNCITRAL documents

A/CN.9/457, paras. 48-52;
A/CN.9/WG.IV/WP.80, para. 15.

Remarks

46. The purpose of draft article 8 is to make it clear that an enacting State may designate an organ or authority that will have the power to make determinations on what specific technologies may qualify as an enhanced electronic signature. The alternative wording in paragraph (1) is to align draft article 8 with the alternatives provided in revised articles 6 and 7. The purpose of paragraph (2) is to encourage States to ensure that determinations made under paragraph (1) conform with international standards where applicable, thus facilitating harmonization of practices with respect to enhanced electronic signatures and cross-border use and recognition of signatures.

Article 9. *[Responsibilities] [duties] of the signature holder*

(1) A signature holder [has a duty to] [shall]:

(a) Exercise due diligence to ensure the accuracy and completeness of all material representations made by the signature holder which are relevant to issuing, *suspending or revoking* a certificate, or which are included in the certificate.

(b) Notify appropriate persons without undue delay in the event that *[it knew its signature had been compromised] [its signature had or might have been compromised]*;

(c) Exercise due care to *retain control* and avoid unauthorized use of its signature, *as of the time when the signature holder has sole control of the signature device.*

(2) *If [there are joint holders][more than one person has control] of the [key][signature device], the [obligations] [duties] under paragraph (1) are joint and several.*

(3) A signature holder shall be [responsible][liable] for its failure to [fulfil the obligations [duties] in][satisfy the requirements of] paragraph (1).

(4) [Liability of the signature holder may not exceed the loss which the signature holder foresaw or ought to have foreseen at the time of its failure in the light of facts or matters which the signature holder knew or ought to have known to be possible consequences of the signature holder's failure to [fulfil the obligations [duties] in][satisfy the requirements of] paragraph (1).]

References to UNCITRAL documents

A/CN.9/457, paras. 65-98;
A/CN.9/WG.IV/WP.80, paras. 18 and 19.

General remarks regarding draft articles 9 and 10

47. The Working Group may wish to consider the relationship between draft articles 9 and 10 in practice. There are a number of possible combinations of the duties in draft article 9 and the consequences of failure to observe those duties in terms of draft article 10. Two of such combinations will serve to illustrate some of the issues to be considered.

48. First, the situation where the signature holder does not breach the duty of exercising reasonable care in draft article 9(1)*(c)*, but nevertheless the signature somehow is compromised. The signature holder does not know of the compromise and so does not notify the information certifier, but is unlikely to be in breach of the duty in draft article 9(1)*(b)*. Under draft article 10, the relying party could not learn of the compromise of the signature by checking information provided by the information certifier, and could rely on the signature. This situation raises a number of questions: Is it reasonable for the relying party to rely in such a situation? Does the relying party bear the risk of reliance? What is the consequence of that reliance for the signature holder? Is the signature holder bound by whatever was signed using the compromised signature?

49. Secondly, the situation where the signature holder does breach the duty of exercising reasonable care in draft article 9(1)*(c)*, and the signature is compromised. The signature holder knows of the compromise and notifies the information certifier. Under draft article 10, the relying party could learn of the compromise of the signature by checking information provided by the information certifier, and then could not rely on the signature. The signature holder is thus responsible under draft article 9(3) for failure to observe the duties in paragraph (1) and liable for loss under paragraph (4). In this situation the result is much clearer than in the situation set forth in paragraph 48.

Remarks

Article 9, paragraph (1)

50. Paragraph (1) of draft article 9 has been revised in accordance with the decisions of the Working Group at its thirty-fourth session (A/CN.9/457, paras. 73-92). The Working Group expressed concern that the duty in subparagraph *(a)* should be limited to the context of the certification process (A/CN.9/457, para. 92), since otherwise the duty might be widely interpreted to include representations and statements made by the signature holder to a relying party. Since representations or statements made in the context of this relationship should be subject to the law of the underlying contract, subparagraph *(a)* has been more narrowly drawn to limit the duty to the context of the process of issuing, suspending or revoking a certificate.

51. Subparagraph *(b)* has been revised to include the two alternative texts agreed by the Working Group (A/CN.9/457, para. 83). The words "or ought to have known" have not been included in this revision on the basis that it would be difficult for the signature holder to satisfy a duty of notification that is based on something it ought to have known, but did not in fact know.

52. Subparagraph *(c)* refers not only to the obligation to avoid unauthorized use of the signature, but also to the obligation to retain control of the key. The revised provision also refers to the time at which the duty to exercise reasonable care arises. This reflects the prevailing view in the Working Group that, while the duty of the key holder to protect the key should only arise with respect to those key pairs that were effectively protected by a certificate, the duty of the key holder to protect certified keys against misuse should apply retroactively to the time at which the signature holder obtained sole control of the key pair (A/CN.9/457, para. 67).

Paragraph (2)

53. Paragraph (2) has been added to draft article 9 in order to clarify the obligation of due care in the situation where there may be more than one holder of the same key. The Working Group may wish to consider this provision and its relationship with requirements for sole control in article 2.

Paragraph (3)

54. This paragraph has been revised in accordance with decisions of the Working Group at its thirty-fourth session (A/CN.9/457, paras. 93-98). Reference to the "consequences of the [signature holder] failing to fulfil the obligations in paragraph (1)" has been deleted (i) to avoid considerations of whether or not the obligation breached was contractual, and (ii) to avoid any uncertainty that might arise from the use of the phrase "the consequences" which might suggest that *all* possible consequences were under consideration, without conveying any idea as to the remoteness of those possible consequences from the failure to fulfil the obligation.

Paragraph (4)

55. This paragraph is based upon article 74 of the United Nations Convention on Contracts for the International Sale of Goods and has been included for further consideration by the Working Group. It establishes a rule based upon a test of foreseeability of damage, but is limited to breach of the obligations of the signature holder in paragraph (1). Some concerns were expressed by the Working Group at its thirty-fourth session (A/CN.9/457, paras. 93-98) that the liability which might arise in the context of a contract for the sale of goods was not the same as the liability that might arise from the use of a signature and could not be quantified in the same way. It was also pointed out that a test of foreseeability might not be appropriate in the context of the contractual relationship between the signature holder and the information certifier, although such a test might be appropriate in the context of the relationship between the signature holder and a relying party. The Working Group may wish to consider these issues in its further deliberations on this draft article and, in addition, the relationship of draft article 9 to draft article 10.

REFERENCES TO NATIONAL LEGISLATION AND OTHER TEXTS

Paragraph (1)(a)*—material representations*

ABA Guidelines

4.2. Subscriber's obligations

All material representations made by the subscriber to a certification authority, including all information known to the subscriber and represented in the certificate, must be accurate to the best of the subscriber's knowledge and belief, regardless of whether such representations are confirmed by the certification authority.

GUIDEC

VII. Ensuring a message

7. Representations to a certifier

A subscriber must accurately represent to a certifier all facts material to the certificate.

Illinois

Article 20. Duties of subscribers

Section 20-101. Obtaining a certificate

All material representations knowingly made by a person to a certification authority for purposes of obtaining a certificate naming such person as a subscriber must be accurate and complete to the best of such person's knowledge and belief.

Section 20-105. Acceptance of a certificate

[...]

(b) By accepting a certificate, the subscriber listed in the certificate represents to any person who reasonably relies on information contained in the certificate, in good faith and during its operational period, that:

(1) the subscriber rightfully holds the private key corresponding to public key listed in the certificate;

(2) all representations made by the subscriber to the certification authority and material to the information listed in the certificate are true; and

(3) all information in the certificate that is within the knowledge of the subscriber is true.

Singapore

Part IX. Duties of subscribers

Obtaining a certificate

37. All material representations made by the subscriber to a certification authority for purposes of obtaining a certificate, including all information known to the subscriber and represented in the certificate, shall be accurate and complete to the best of the subscriber's knowledge and belief, regardless of whether such representations are confirmed by the certification authority.

Paragraph (1)(b)*—notification*

ABA Guidelines

4.4. Initiating suspension or revocation

A subscriber who has accepted a certificate must request the issuing certification authority to suspend or revoke the certificate if the private key corresponding to the public key listed in the certificate has been compromised.

Illinois

Article 20. Duties of subscribers

Section 20-110. Revocation of a certificate

Except as otherwise provided by another applicable rule of law, if the private key corresponding to the pub-

lic key listed in a valid certificate is lost, stolen, accessible to an unauthorized person, or otherwise compromised during the operational period of the certificate, a subscriber who has learned of the compromise must promptly request the issuing certification authority to revoke the certificate and publish a notice of revocation in all repositories in which the subscriber previously authorized the certificate to be published, or otherwise provide reasonable notice of the revocation.

Section 10-125. Creation and control of signature devices

Except as otherwise provided by another applicable rule of law, whenever the creation, validity, or reliability of an electronic signature created by a qualified security procedure under [...] is dependent upon the secrecy or control of a signature device of the signer:

(1) the person generating or creating the signature device must do so in a trustworthy manner;

(2) the signer and all other persons that rightfully have access to such signature device must exercise reasonable care to retain control and maintain the secrecy of the signature device, and to protect it from any unauthorized access, disclosure, or use, during the period when reliance on a signature created by such device is reasonable;

(3) in the event that the signer, or any other person that rightfully has access to such signature device, knows or has reason to know that the secrecy or control of any such signature device has been compromised, such person must make a reasonable effort to promptly notify all persons that such person knows might foreseeably be damaged as a result of such compromise, or where an appropriate publication mechanism is available [...], to publish notice of the compromise and a disavowal of any signatures created thereafter.

Singapore

Initiating suspension or revocation

40. A subscriber who has accepted a certificate shall as soon as possible request the issuing certification authority to suspend or revoke the certificate if the private key corresponding to the public key listed in the certificate has been compromised.

Paragraph (1)(c)*—unauthorized use*

ABA Guidelines

4.3. Safeguarding the private key

During the operational period of a valid certificate, the subscriber shall not compromise the private key corresponding to a public key listed in such certificate, and must also avoid compromise during any period of suspension.

GUIDEC

VII. Ensuring a message

6. Safeguarding an ensuring device

If a person ensures a message by means of a device, the person must exercise, at a minimum, reasonable care to prevent unauthorized use of the device.

Illinois

Section 10-125 Creation and control of signature devices

Except as otherwise provided by another applicable rule of law, whenever the creation, validity, or reliability of an electronic signature created by a qualified security procedure under [...] is dependent upon the secrecy or control of a signature device of the signer:

(1) the person generating or creating the signature device must do so in trustworthy manner;

(2) the signer and all other persons that rightfully have access to such signature device must exercise reasonable care to retain control and maintain the secrecy of the signature device, and to protect it from any unauthorized access, disclosure, or use, during the period when reliance on a signature created by such device is reasonable;

(3) in the event that the signer, or any other person that rightfully have access to such signature device, knows or has reason to know that the secrecy or control of any such signature device has been compromised, such person must make a reasonable effort to promptly notify all persons that such person knows might foreseeably be damaged as a result of such compromise, or where an appropriate publication mechanism is available [...] to publish notice of the compromise and a disavowal of any signature created thereafter.

Paragraphs (3) and (4)—liability

Minnesota

325K.12. Representations and duties upon accepting certificates

Subd.4 Indemnification by subscriber

By accepting a certificate, a subscriber undertakes to indemnify the issuing certification authority for loss or damage caused by issuance or publication of a certificate in reliance on:

(1) a false and material representation of fact by the subscriber;

(2) the failure by the subscriber to disclose a material fact if the representation or failure to disclose was made either with intent to deceive the certification authority or a person relying on the certificate, or with gross negligence. The indemnity provided in this sec-

tion may not be disclaimed or contractually limited in scope. However, a contract may provide consistent, additional terms regarding the indemnification.

Singapore

Part IX. Duties of subscribers

Control of private key

39. (1) By accepting a certificate issued by a certification authority, the subscriber identified in the certificate assumes a duty to exercise reasonable care to retain control of the private key corresponding to the public key listed in such certificate and prevent its disclosure to a person not authorized to create the subscriber's digital signature.

(2) Such duty shall continue during the operational period of the certificate and during any period of suspension of the certificate.

Article 10. *Reliance on an enhanced electronic signature*

(1) A person [is] [is not] entitled to rely on an enhanced electronic signature to the extent that it [is] [is not] reasonable to do so.

(2) In determining whether reliance [is][is not] reasonable, regard shall be had, if appropriate, to:

(a) the nature of the underlying transaction that the signature was intended to support;

(b) whether the relying party has taken appropriate steps to determine the reliability of the signature;

(c) whether the relying party knew or ought to have known that the signature had been compromised or revoked;

(d) any agreement or course of dealing which the relying party has with the subscriber, or any trade usage which may be applicable;

(e) any other relevant factor.

Article 11. *Reliance on certificates*

(1) A person [is] [is not] entitled to rely on a certificate to the extent that it [is] [is not] reasonable to do so.

(2) In determining whether reliance [is][is not] reasonable, regard shall be had, if appropriate, to:

(a) any restrictions placed upon the certificate;

(b) whether the relying party has taken appropriate steps to determine the reliability of the certificate, including reference to a certificate revocation list where relevant;

(c) any agreement or course of dealing which the relying party has with the information certifier or subscriber or any trade usage which may be applicable;

(d) [any] [all] other relevant factor[s].

References to UNCITRAL documents

A/CN.9/457, paras. 99-107;
A/CN.9/WG.IV/WP.80, paras. 20 and 21.

Remarks

56. Draft articles 10 and 11, which deal respectively with the reasonableness of reliance on enhanced electronic signatures and certificates, have been redrafted in accordance with the prevailing view of the Working Group at its thirty-fourth session (A/CN.9/457, para. 107) as to content. Although originally proposed as a single article dealing with both reliance on signatures and reliance on signatures supported by a certificate, the current draft separates these two concepts on the basis that different considerations apply to each situation. The Working Group may wish to consider whether there is a need to include a rule on reliance on certificates in addition to a rule on reliance on signatures and what the considerations that would establish reasonable reliance in each case should be.

57. Some concern was expressed by the Working Group that formulating draft articles 10 and 11 as entitlements to rely might presume certain legal effects, while establishing the factors to be considered in deciding whether reliance could be regarded as reasonable might avoid addressing the issue of what legal effect the signature or certificate might have. An opposing view was that formulating the draft articles as an entitlement to rely added a benefit that was not available under the Model Law, and did not establish legal effect in terms of the validity of the signature. As agreed by the Working Group, the revised draft articles include both a positive and negative form and set out the factors to be taken into consideration in the case of signatures and in the case of certificates.

58. Some concern was also expressed as to the relationship between draft articles 10 and 11 and article 13 of the Model Law and whether draft articles 9, 10 and 11, when read together, would establish a rule on attribution. The Working Group may wish to consider the relationship of draft articles 10 and 11 to draft article 9 and to article 13 of the Model Law.

REFERENCES TO NATIONAL LEGISLATION AND OTHER TEXTS

ABA Guidelines

5.3 Unreliable digital signatures

(1) [...]

(2) Unless otherwise provided by law or contract, a relying party assumes the risk that a digital signature is invalid as a signature or authentication of the signed message, if reliance on the digital signature is not reasonable under the circumstances in accordance with the factors listed in Guideline 5.4 (reasonableness of reliance).

5.4 Reasonableness of reliance

The following factors, among others, are significant in evaluating the reasonableness of a recipient's reliance upon a certificate, and upon digital signatures verifiable with reference to the public key listed in the certificate:

(1) facts which the relying party knows or of which the relying party has notice, including all facts listed in the certificate or incorporated in it by reference;

(2) the value or importance of the digitally signed message, if known;

(3) the course of dealing between the relying person and subscriber and the available indicia of reliability or unreliability apart from the digital signature;

(4) usage of trade, particularly trade conducted by trustworthy systems or other computer-based means.

2.3 Reliance on certificates foreseeable

It is foreseeable that persons relying on a digital signature will also rely on a valid certificate containing the public key by which the digital signature can be verified.

GUIDEC

VIII. Certification

1. Effect of a valid certificate

A person may rely on a valid certificate as accurately representing the fact or facts set forth in it, if the person has no notice that the certifier has failed to satisfy a material requirement of ensured message practice.

Singapore

Part VI. Effect of digital signatures

Unreliable digital signatures

22. Unless otherwise provided by law or contract, a person relying on a digitally signed electronic record assumes the risk that the digital signature is invalid as a signature or authentication of the signed electronic record, if reliance on the digital signature is not reasonable under the circumstances having regard to the following factors:

(a) facts which the person relying on the digitally signed electronic record knows or has notice of, including all facts listed in the certificate or incorporated in it by reference;

(b) the value or importance of the digitally signed electronic record, if known;

(c) the course of dealing between the person relying on the digitally signed electronic record and the subscriber and the available indicia of reliability or unreliability apart from the digital signature; and

(d) any usage of trade, particularly trade conducted by trustworthy systems or other electronic means.

Article 12. *[Responsibilities][duties] of an information certifier*

(1) [An information certifier is [obliged to[shall]] [inter alia]:

(a) act in accordance with the representations it makes with respect to its practices;

(b) take reasonable steps to ascertain the accuracy of any facts or information that the information certifier certifies in the certificate, [including the identity of the signature holder];

(c) provide reasonably accessible means which enable a relying party to ascertain:

(i) the identity of the information certifier;

(ii) that the person who is [named][identified] in the certificate holds [at the relevant time] the [private key corresponding to the public key][signature device] referred to in the certificate;

[*(iii) that the keys are a functioning key pair];*

(iv) the method used to identify the signature holder;

(v) any limitations on the purposes *or value* for which the signature may be used; and

(vi) whether the signature device is valid and has not been compromised;

(d) provide a means for signature holders to give notice that an enhanced electronic signature has been compromised *and ensure the operation of a timely revocation service;*

(e) exercise due diligence to ensure the accuracy and completeness of all material representations made by the information certifier *that are relevant to issuing, suspending or revoking a certificate or which are included in the certificate*;

(f) Utilize trustworthy systems, procedures *and human resources* in performing its services.

Variant X

(2) An information certifier shall be [responsible] [liable] for its failure to [fulfil the obligations [duties] in][satisfy the requirements of] paragraph (1).

(3) Liability of the information certifier may not exceed the loss which the information certifier foresaw or ought to have foreseen at the time of its failure in the light of facts or matters which the information certifier knew or ought to have known to be possible consequences of the information certifier's failure to [fulfil the obligations [duties] in][satisfy the requirements of] paragraph (1).

Variant Y

(2) Subject to paragraph (3), if the damage has been caused as a result of the certificate being incorrect or defective, an information certifier shall be liable for damage suffered by either:

(a) a party who has contracted with the information certifier for the provision of a certificate; or

(b) any person who reasonably relies on a certificate issued by the information certifier.

(3) An information certifier shall not be liable under paragraph (2):

(a) if, and to the extent, it included in the certificate a statement limiting the scope or extent of its liability to any person; or

(b) if it proves that it [was not negligent][took all reasonable measures to prevent the damage].

References to UNCITRAL documents

A/CN.9/457, paras. 108-119;
A/CN.9/WG.IV/WP.80, paras. 22-24.

Remarks

59. Draft article 12 has been revised in accordance with decisions of the Working Group at its thirty-fourth session (A/CN.9/457, paras. 108-119).

Paragraph (1)

60. The opening words of paragraph (1) include several alternatives. The first relates to whether the provision should be drafted using the form "is obliged to" or "shall". The second relates to the use of the words "inter alia". If that is used, draft article 12 would set forth an open-ended, illustrative list of duties. While such a formulation might appear burdensome to information certifiers, the Working Group was of the view that it would not be inconsistent with the general rule currently applying to information certifiers in many legal systems. If the words "inter alia" are omitted, draft article 12 would set forth an exhaustive list of duties of an information certifier, allowing the exact scope of the liability of the information certifier to be determined and avoiding difficulties which might arise with a different formulation in countries in which an information certifier might not be under a general duty of due diligence.

61. As to the specific duties included in paragraph (1), these have been extended to reflect the views of the Working Group (A/CN.9/457, paras. 112-114). With regard to subparagraph *(c)*, the information to be provided through "reasonably accessible means" includes some information which a relying party might reasonably expect to be included on a certificate and other information which could only be obtained by reference to some other source, such as a certificate revocation list. The Working Group might wish to consider whether some of this information should be specified for inclusion in a certificate and whether an additional rule setting out the minimum contents of a certificate should be included in the Uniform Rules.

62. Paragraph (1)*(c)*(ii) refers both to a "key pair" and to a "signature device". To ensure that the Uniform Rules are technology neutral, the Working Group may wish to consider the use of a technology neutral formulation such as "signature device" as an alternative to the words "key pair", since "key pair" refers specifically to digital signatures. Use of the phrase "key pair" in relation to the definition of "certificate" may be appropriate in situations where certificates are only used in a digital signature context.

63. Paragraph (1)*(c)*(iii) has been included as proposed at the previous session, but the Working Group may wish to consider whether this is an appropriate requirement. If the public key referred to in the certificate corresponds to the private key held by the signature holder and there is, therefore, a mathematical correspondence between the two keys, it is not clear what additional functionality would be achieved by a requirement that the key pair be "a functioning key pair". It is also uncertain whether the information certifier could provide information, in addition to what is required by paragraph (1)*(c)*(ii), that would indicate that additional functionality.

Paragraphs (2) and (3)

64. Variant X establishes a rule that the information certifier is responsible for its failure to observe the obligations or duties in paragraph (1), but leaves it up to national law to determine what the consequences of that failure might be. The words "the consequences of" have been deleted in this revised draft article 12 for the same reasons that were given for their deletion in paragraph (3) of draft article 9. These were (i) to avoid considerations of whether or not the obligation breached was contractual and (ii) to avoid any uncertainty that might arise from the use of "the consequences" which might suggest that *all* possible consequences were under consideration, without conveying any idea as to the remoteness of those possible consequences from the failure to fulfil the obligation.

65. Following the revision of paragraph (1) to include two variations—an exhaustive list of obligations and an open-ended, illustrative list of obligations—the Working Group may wish to consider whether Variant X would be more appropriate in the case where paragraph (1) was phrased as an exhaustive list, rather than the open-ended alternative.

66. Paragraph (3) of Variant X establishes a rule of foreseeability of damage based upon article 74 of the United Nations Convention on Contracts for the International Sale of Goods, This paragraph operates to limit the quantum of any liability of the information certifier which might arise from paragraphs (1) and (2).

Variant Y

67. It was widely felt in the Working Group (A/CN.9/457, para. 115) that it would be appropriate to create a uniform rule that went beyond merely referring to the applicable law and established a general rule of liability for negligence, subject to possible contractual exemptions (provided that the limitation would not be grossly unfair) and subject to the information certifier exonerating itself by demonstrating that it had fulfilled the obligations under paragraph (1). Paragraph (2) of Variant Y deals with the question of to whom the information certifier may be liable. Paragraph (3) provides a rule permitting the information certifier to rely on any limitation of liability set out in the certificate or to show that it was not negligent or took reasonable measures to prevent the damage occurring.

68. As in the case of Variant X, the Working Group may wish to consider whether a provision such as proposed in Variant Y would be appropriate in the context of an exhaustive list of duties under paragraph (1), but not where

the obligations were open-ended. It may also wish to consider whether it needs to be made clear in draft paragraph (2) of Variant Y that the liability of the information certifier is limited to its failure to perform the obligations in paragraph (1).

REFERENCES TO NATIONAL LEGISLATION AND OTHER TEXTS

Article 12 paragraph (1)—general duties

ABA Guidelines

3. Certification authorities

3.1. Certification authority must use trustworthy systems

A certification authority must utilize trustworthy systems in performing its services.

3.2. Disclosure

(1) A certification authority must disclose any material certification practice statement, as well as notice of the revocation or suspension of a certification authority certificate.

(2) A certification authority must use reasonable efforts to notify any persons who are known to be or foreseeably will be affected by the revocation or suspension of its certification authority certificate.

(3) [...]

(4) In the event of an occurrence which materially and adversely affects a certification authority's trustworthy system or its certification authority certificate, the certification authority must use reasonable efforts to notify any persons who are known to be or foreseeably will be affected by that occurrence, or act in accordance with procedures specified in its certification practice statement.

3.7. Certification authority's representations in certificate

By issuing a certificate, a certification authority represents to any person who reasonably relies on a certificate or a digital signature verifiable by the public key listed in the certificate, that the certification authority, in accordance with any applicable certification practice statement of which the relying person has notice, has confirmed that:

(1) the certification authority has complied with all applicable requirements of these Guidelines in issuing the certificate, and if the certification authority has published the certificate or otherwise made it available to such reasonably relying person, that the subscriber listed in the certificate has accepted it;

(2) the subscriber identified in the certificate holds the private key corresponding to the public key listed in the certificate;

(3) [...]

(4) the subscriber's public key and private key constitute a functioning key pair; and

(5) all information in the certificate is accurate, unless the certification authority has stated in the certificate or incorporated by reference in the certificate that the accuracy of specified information is not confirmed.

Further, the certification authority represents that there are no known, material facts omitted from the certificate which would, if known, adversely affect the reliability of its representations under this Guideline.

3.9. Suspension of certificate at subscriber's request

Unless a contract between the certification authority and the subscriber provides otherwise, a certification authority must suspend a certificate as soon as possible after a request by a person whom the certification authority reasonably believes to be:

(1) the subscriber listed in the certificate;

(2) a person duly authorized to act for that subscriber; or

(3) a person acting on behalf of that subscriber, who is unavailable.

3.10. Revocation of certificate at subscriber's request

The certification authority which issued a certificate must revoke it at the request of the subscriber listed in it, if the certification authority has confirmed:

(1) that person requesting revocation is the subscriber listed in the certificate to be revoked; or

(2) if the requester is acting as an agent, that the requester has sufficient authority to effect revocation.

3.11. Revocation or suspension without the subscriber's consent

A certification authority must suspend or revoke a certificate, regardless of whether the subscriber listed in the certificate consents, if the certification authority confirms that:

(1) a material fact represented in the certificate in false;

(2) a material prerequisite to issuance of the certificate was not satisfied; or

(3) the certification authority's private key or trustworthy system was compromised in a manner materially affecting the certificate's reliability.

Upon affecting such a suspension, or revocation, the certification authority must promptly notify the subscriber listed in the suspended or revoked certificate.

3.12. Notice of suspension or revocation

Promptly upon suspending or revoking a certificate, a certification authority must publish notice of the suspension or revocation if the certificate was published, and otherwise must disclose the fact of suspension or revocation on inquiry by a relying party.

EC Draft Directive

Annex II. Requirements for certification service providers issuing qualified certificates

Certification service providers must:

(a) demonstrate the reliability necessary for offering certification services;

(b) ensure the operation of a prompt and secure directory and secure and immediate revocation service;

(ba) ensure that the date and time, when a certificate is issued or revocated, can be determined;

(c) verify by appropriate means in accordance with national law the identity and if applicable any specific attributes of the person to which a qualified certificate is issued;

(d) employ personnel which possesses the expert knowledge, experience, and qualifications necessary for the offered services, in particular competence at the managerial level, expertise in electronic signature technology and familiarity with proper security procedures; they must also exercise administrative and management procedures and processes that are adequate and which correspond to recognized standards;

(e) use trustworthy systems and products which are protected against modification and which must ensure the technical and cryptographic security of the processes supported by them;

(f) take measures against forgery of certificates, and, in cases where the certification service provider generates signature creation data, guarantee the confidentiality during the process of generating that data;

(g) maintain sufficient financial resources to operate in conformity with the requirements laid down in this Directive, in particular to bear the risk of liability for damages, for example, by obtaining an appropriate insurance;

(h) record all relevant information concerning a qualified certificate for an appropriate period of time, in particular to provide evidence of certification for the purposes of legal proceedings. Such recording may be done electronically;

(i) not store or copy signature creation data of the person to whom the certification service provider offered key management services;

(j) before entering into a contractual relationship with a person seeking a certificate from it to support his electronic signature, inform that person by a durable means of communication of the precise terms and conditions for the use of the certificate, including any limitations on the use of the certificate, the existence of a voluntary accreditation and the procedures for complaints and dispute settlement. Such information must be in writing which may be transmitted electronically and in readily understandable language. Relevant parts of this information must also be made available on request to third parties relying on the certificate;

(k) use trustworthy systems to store certificates in a verifiable form so that:

- only authorized persons can make entries and changes;
- information can be checked for authenticity;
- certificates are publicly available for retrieval only in those cases for which the certificate holder's consent has been obtained; and
- any technical changes compromising these security requirements will be apparent to the operator.

Germany

§5 Issuance of certificates

(1) The certifier shall reliably identify persons who apply for a certificate. It shall confirm the attribution of a public signature key to an identified person by a signature key certificate and shall maintain access to such, as well as to attribute certificates, at all times and for everyone over publicly accessible telecommunications channels in a verifiable manner and with the agreement of the signature key owner.

(2) Upon request of an applicant, the certifier shall record information concerning the applicant's power of representation for a third party or its professional or other licensing in the signature key certificate or in an attribute certificate, insofar as such licensing or the consent of the third party that the power of representation be recorded is reliably demonstrated.

(3) Upon request of an applicant, the certifier shall record a pseudonym in the certificate in place of the applicant's name.

(4) The certifier shall take measures so that data for certificates cannot be forged or falsified in a way which is not visible. It shall furthermore take steps so that the confidentiality of private signature keys is guaranteed. Private signature keys may not be stored by a certifier.

(5) It shall use reliable personnel for the exercise of certification activities, and shall use technical components in accordance with §14 for making signature keys accessible and creating certificates. This also applies to technical components which make possible the verification of certificates under paragraph 1, sentence 2.

§6 Duty of instruction

The certifier shall instruct the applicant under §5 paragraph 1 concerning the measures necessary to contribute to secure digital signatures and their reliable verification. It shall instruct the applicant concerning which technical components fulfil the requirements of §14, paragraphs 1 and 2, as well as concerning the attribution of digital signatures created with a private signature key. It shall point out to the applicant that data with digital signatures may need to be re-signed before the security value of an available signature decreases with time.

§8 Blocking of certificates

(1) A certifier shall block a certificate if a signature key owner or his representative so request, if the certificate was issued based on false information under §7, if the certifier has ended its activities and they are not continued by another certifier, or if the Authority orders blocking under §13, paragraph 5, sentence 2. The blocking shall indicate the time from which it applies. Retroactive blocking is not permitted.

GUIDEC

VIII. Certification

2. Accuracy of representations in certificate

A certifier must confirm the accuracy of all facts set forth in a valid certificate, unless it is evident from the certificate itself that some of the information has not been verified.

3. Trustworthiness of a certifier

A certifier must:

(a) use only technologically reliable information systems and processes, and trustworthy personnel in issuing a certificate and in suspending or revoking a public key certificate and in safeguarding its private key, if any;

(b) have no conflict of interest which would make the certifier untrustworthy in issuing, suspending, and revoking a certificate;

(c) refrain from contributing to a breach of duty by the subscriber;

(d) refrain from acts or omissions which significantly impair reasonable and foreseeable reliance on a valid certificate;

(e) act in a trustworthy manner towards a subscriber and persons who rely on a valid certificate.

4. Notice of practices and problems

A certifier must make reasonable efforts to notify a foreseeably affected person of:

(a) any material certification practice statement; and

(b) any fact material to either the reliability of a certificate which it has issued or its ability to perform its services.

8. Suspension of public key certificate by request

The certifier which issued a certificate must suspend it promptly upon request by a person identifying himself as the subscriber named in a public key certificate, or as a person in a position likely to know of a compromise of the security of a subscriber's private key, such as an agent, employee, business associate, or member of the immediate family of the subscriber.

9. Revocation of public key certificate by request

The certifier which issued a public key certificate must revoke it promptly after:

(a) receiving a request for revocation by the subscriber named in the certificate or that subscriber's authorized agent; and

(b) confirming that the person requesting revocation is that subscriber, or is an agent of that subscriber with authority to request the revocation.

10. Suspension or revocation of public key certificate without consent

The certifier which issued a public key certificate must revoke it, if:

(a) the certifier confirms that a material fact represented in the certificate is false;

(b) the certifier confirms that the trustworthiness of the certifier's information system was compromised in a manner materially affecting the certificate's reliability.

The certifier may suspend a reasonably questionable certificate for the time necessary to perform an investigation sufficient to confirm grounds for revocation pursuant to this article.

11. Notice of revocation or suspension of a public key certificate

Immediately upon suspension or revocation of a public key certificate by a certifier, the certifier must give appropriate notice of the revocation or suspension.

Illinois

Article 15. Effect of a digital signature

Section 15-301. Trustworthy services

Except as conspicuously set forth in its certification practice statement, a certification authority and a person maintaining a repository must maintain its operation and perform its services in a trustworthy manner.

Section 15-305. Disclosure

(a) For each certificate issued by a certification authority with the intention that it will be relied upon by third parties to verify digital signature created by subscribers, a certification authority must publish or otherwise make available to the subscriber and all such relying parties:

(1) its certification practice statement, if any, applicable thereto; and

(2) its certificate that identifies the certification authority as a subscriber and that contains the public key corresponding to the private key used by the certification authority to digitally sign the certificate (its "certification authority certificate").

(b) In the event of an occurrence that materially and adversely affects a certification authority's operations or system, its certification authority certificate, or any other aspect of its ability to operate in a trustworthy manner, the certification authority must act in accordance with procedures governing such an occurrence specified in its certification practice statement, or in the absence of such procedures, must use reasonable efforts to notify any persons that the certification authority knows might foreseeably be damaged as a result of such occurrence.

Section 15-310. Issuance of a certificate

A certification authority may issue a certificate to a prospective subscriber for the purpose of allowing third parties to verify digital signatures created by the subscriber only after:

(1) the certification authority has received a request for issuance from the prospective subscriber, and

(2) the certification authority has:

(a) complied with all of the relevant practices and procedures set forth in its applicable certification practice statement, if any; or

(b) in the absence of a certification practice statement addressing these issues, confirmed in a trustworthy manner that:

(i) the prospective subscriber is the person to be listed in the certificate to be issued;

(ii) the information in the certificate to be issued is accurate; and

(iii) the prospective subscriber rightfully holds a private key capable of creating a digital signature, and the public key to be listed in the certificate can be used to verify a digital signature affixed by such private key.

Section 15-315. Representations upon issuance of certificate

(a) By issuing a certificate with the intention that it will be relied upon by third parties to verify digital signatures created by the subscriber, a certification authority represents to the subscriber, and to any person who reasonably relies on information contained in the certificate, in good faith and during its operational period, that:

(1) the certification authority has processed, approved, and issued, and will manage and revoke if necessary, the certificate in accordance with its applicable certification practice statement stated or incorporated by reference in the certificate or of which such person has notice, or in lieu thereof, in accordance with this Act or the law of the jurisdiction governing issuance of the certificate;

(2) the certification authority has verified the identity of the subscriber to the extent stated in the certificate or its applicable certification practice statement, or in lieu thereof, that the certification authority has verified the identity of the subscriber in a trustworthy manner;

(3) the certification authority has verified that the person requesting the certificate holds the private key corresponding to the public key listed in the certificate; and

(4) except as conspicuously set forth in the certificate or its applicable certification practice statement, to the certification authority's knowledge as of the date the certificate was issued, all other information in the certificate is accurate, and not materially misleading.

(b) 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.

Section 15-320. Revocation of a certificate

(a) 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 its applicable certification practice statement, or in the absence of such policies and procedures, as soon as possible after:

(1) receiving a request for revocation by the subscriber named in the certificate, and confirming that the person requesting revocation is the subscriber, or is an agent of the subscriber with authority to request the revocation;

(2) receiving a certified copy of an individual subscriber's death certificate, or upon confirming by other reliable evidence that the subscriber is dead;

(3) being presented with documents effecting a dissolution of a corporate subscriber, or confirmation by other evidence that the subscriber has been dissolved or has ceased to exist;

(4) being served with an order requiring revocation that was issued by a court of competent jurisdiction; or

(5) confirmation by the certification authority that:

(a) a material fact represented in the certificate is false,

(b) a material prerequisite to issuance of the certificate was not satisfied,

(c) the certification authority's private key or system operations were compromised in a manner materially affecting the certificate's reliability, or

(d) the subscriber's private key was compromised.

(b) Upon effecting such a revocation, the certification authority must notify the subscriber and relying parties in accordance with the policies and procedures governing notice of revocation specified in its applicable certification practice statement, or in the absence of such policies and procedures, promptly notify the subscriber, promptly publish notice of the revocation in all repositories where the certification authority previously caused publication of the certificate, and otherwise disclose the fact of revocation on inquiry by a relying party.

Singapore

Part VIII. Duties of certification authorities

Trustworthy system

27. A certification authority must utilize trustworthy systems in performing its services.

Disclosure

28. (1) A certification authority shall disclose:

(a) its certificate that contains the public key corresponding to the private key used by that certification authority to digitally sign another certificate (referred to in this section as a certification authority certificate);

(b) any relevant certification practice statement;

(c) notice of the revocation or suspension of its certification authority certificate; and

(d) any other fact that materially and adversely affects either the reliability of a certificate that the authority has issued or the authority's ability to perform its services.

(2) In the event of an occurrence that materially and adversely affects a certification authority's trustworthy system or its certification authority certificate, the certification authority shall:

(a) use reasonable efforts to notify any person who is known to be or foreseeably will be affected by that occurrence; or

(b) act in accordance with procedures governing such an occurrence specified in its certification practice statement.

Issuing of certificate

29. (1) A certification authority may issue a certificate to a prospective subscriber only after the certification authority:

(a) has received a request for issuance from the prospective subscriber; and

(b) has:

(i) if it has a certification practice statement, complied with all of the practices and procedures set forth in such certification practice statement including procedures regarding identification of the prospective subscriber; or

(ii) in the absence of a certification practice statement, complied with the conditions in subsection (2).

(2) In the absence of a certification practice statement, the certification authority shall confirm by itself or through an authorized agent that:

(a) the prospective subscriber is the person to be listed in the certificate to be issued;

(b) if the prospective subscriber is acting through one or more agents, the subscriber authorized the agent to have custody of the subscriber's private key and to request issuance of a certificate listing the corresponding public key;

(c) the information in the certificate to be issued is accurate;

(d) the prospective subscriber rightfully holds the private key corresponding to the public key to be listed in the certificate;

(e) the prospective subscriber holds a private key capable of creating a digital signature; and

(f) the public key to be listed in the certificate can be used to verify a digital signature affixed by the private key held by the prospective subscriber.

Representations upon issuance of certificate

30. (1) By issuing a certificate, a certification authority represents to any person who reasonably relies on the certificate or 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.

(2) In the absence of such certification practice statement, the certification authority represents that it has confirmed that:

(a) the certification authority has complied with all applicable requirements of this Act in issuing the certificate, and if the certification authority has published the certificate or otherwise made it available to such relying person, that the subscriber listed in the certificate has accepted it;

(b) the subscriber identified in the certificate holds the private key corresponding to the public key listed in the certificate;

(c) the subscriber's public key and private key constitute a functioning key pair;

(d) all information in the certificate is accurate, 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) the certification authority has no knowledge of any material fact which if it had been included in the certificate would adversely affect the reliability of the representations in paragraphs *(a)* to *(d)*.

(3) Where there is an applicable certification practice statement which has been incorporated by reference in the certificate, or of which the relying person has notice, subsection (2) shall apply to the extent that the representations are not inconsistent with the certification practice statement.

Suspension of certificate

31. Unless the certification authority and the subscriber agree otherwise, the certification authority that issued a certificate shall suspend the certificate as soon as possible after receiving a request by a person whom the certification authority reasonably believes to be:

(a) the subscriber listed in the certificate;

(b) a person duly authorized to act for that subscriber; or

(c) a person acting on behalf of that subscriber, who is unavailable.

Revocation of certificate

32. A certification authority shall revoke a certificate that it issued:

(a) after receiving a request for revocation by the subscriber named in the certificate; and confirming that the person requesting the revocation is the subscriber, or is an agent of the subscriber with authority to request the revocation;

(b) after receiving a certified copy of the subscriber's death certificate, or upon confirming by other evidence that the subscriber is dead; or

(c) upon presentation of documents effecting a dissolution of the subscriber, or upon confirming by other evidence that the subscriber has been dissolved or has ceased to exist.

Revocation without subscriber's consent

33. (1) A certification authority shall revoke a certificate, regardless of whether the subscriber listed in the certificate consents, if the certification authority confirms that:

(a) a material fact represented in the certificate is false;

(b) a requirement for issuance of the certificate was not satisfied;

(c) the certification authority's private key or trustworthy system was compromised in a manner materially affecting the certificate's reliability;

(d) an individual subscriber is dead; or

(e) a subscriber has been dissolved, wound-up or otherwise ceased to exist.

(2) Upon effecting such a revocation, other than under subsection (1)*(d)* or *(e)*, the certification authority shall immediately notify the subscriber listed in the revoked certificate.

Notice of suspension

34. (1) Immediately upon suspension of a certificate by a certification authority, the certification authority shall publish a signed notice of the suspension in the repository specified in the certificate for publication of notice of suspension.

(2) Where one or more repositories are specified, the certification authority shall publish signed notices of the suspension in all such repositories.

Notice of revocation

35. (1) Immediately upon revocation of a certificate by a certification authority, the certification authority shall publish a signed notice of the revocation in the repository specified in the certificate for publication of notice of revocation.

(2) Where one or more repositories are specified, the certification authority shall publish signed notices of the revocation in all such repositories.

Article 12 paragraphs (2) and (3)—liability

ABA Guidelines

3.14. Liability of complying certification authority

A certification authority that complies with these Guidelines and any applicable law or contract is not liable for any loss which:

(1) is incurred by the subscriber of a certificate issued by that certification authority, or any other person, or

(2) is caused by reliance upon a certificate issued by the certification authority, upon a digital signature verifiable with reference to a public key listed in a certificate, or upon information represented in such a certificate or repository.

EC Draft Directive

Article 6. Liability

1. As a minimum, member States shall ensure that by issuing a certificate as a qualified certificate to the public or by guaranteeing a certificate to the public a certification service provider is liable for damage caused to any person who reasonably relies on the certificate for:

(a) accuracy of all information in the qualified certificate as of the time of issuance;

(b) [...]

(c) assurance that at the time of the issuance of the certificate, the person identified in the qualified certificate held the signature creation data corresponding to the signature verification data given or identified in the certificate;

(d) assurance that the signature creation data and the signature verification data can be used in a complementary manner, in cases where the certification service provider generates them both;

unless the certification service provider proves that he has not acted negligently.

1a. As a minimum, member States shall ensure that a certification service provider who has issued a certificate as a qualified certificate to the public is liable for damage caused to any person who reasonably relies on the certificate for failure to register revocation of the certificate unless the certification service provider proves that he has not acted negligently.

3. Member States shall ensure that a certification service provider may indicate in the qualified certificate limits on the uses of a certain certificate, the limit must be recognizable to third parties. The certification service provider shall not be liable for damages arising from a contrary use of a qualified certificate which includes limits on its uses.

4. Member States shall ensure that a certification service provider may indicate in the qualified certificate a limit on the value of transactions for which the certificate can be used.

Missouri

Section 17.1

By specifying a recommended reliance limit in a certificate, the issuing certification authority and the accepting subscriber recommend that persons rely on the certificate only to the extent that the total amount at risk does not exceed the recommended reliance limit.

Section 17.2

Unless a licensed certification authority waives application of this subsection, a licensed certification authority is:

(1) not liable for any loss caused by reliance on a false or forged digital signature of a subscriber, if, with respect to the false or forged digital signature, the certification authority complied with all material requirements of sections 1 to 27 of this act;

(2) not liable in excess of the amount specified in the certificate as its recommended reliance limit for either:

(a) a loss caused by reliance on a misrepresentation in the certificate of any fact that the licensed certification authority is required to confirm; or

(b) failure to comply with section 10 of this Act in issuing the certificate;

(3) liable only for direct, compensatory damages in any action to recover a loss due to reliance on the certificate, which damages do not include:

(a) punitive or exemplary damages;

(b) damages for lost profit, savings or opportunity; or

(c) damages for pain or suffering.

Singapore

Liability limits for licensed certification authorities

45. Unless a licensed certification authority waives the application of this section, a licensed certification authority:

(a) shall not be liable for any loss caused by reliance on a false or forged digital signature of a subscriber, if, with respect to the false or forged digital signature, the licensed certification authority complied with the requirements of this Act;

(b) shall not be liable in excess of the amount specified in the certificate as its recommended reliance limit for either:

(i) a loss caused by reliance on a misrepresentation in the certificate of any fact that the licensed certification authority is required to confirm; or

(ii) failure to comply with sections 29 and 30 in issuing the certificate.

Article 13. *Recognition of foreign certificates and signatures*

(1) In determining whether, or the extent to which, a certificate [signature] is legally effective, no regard shall be had to the place where the certificate [signature] was issued, nor to the State in which the issuer had its place of business.

Variant A

(2) Certificates issued by a foreign information certifier are recognized as legally equivalent to certificates issued by information certifiers operating under ... *[the law of the enacting State]* if the practices of the foreign information certifiers provide a level of reliability at least equivalent to that required of information certifiers under ... *[the law of the enacting State]*. [Such recognition may be made through a published determination of the State or through bilateral or multilateral agreement between or among the States concerned.]

(3) Signatures complying with the laws of another State relating to digital or other electronic signatures are recognized as legally equivalent to signatures under ... *[the law of the enacting State]* if the laws of the other State require a level of reliability at least equivalent to that required for such 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.]

(4) Notwithstanding the preceding paragraph, parties to commercial and other transactions may specify that a particular information certifier, class of information certifier or class of certificates must be used in connection with messages or signatures submitted to them.

Variant B

(2) Certificates issued by a foreign information certifier are recognized as legally equivalent to certificates issued by information certifiers operating under [*the law of the enacting State*] if the practices of the foreign information certifier provide a level of reliability at least equivalent to that required of information certifiers under ... *[the law of the enacting State]*.

[(3) The determination of equivalence described in paragraph (2) may be made by a published determination of the State or through bilateral or multilateral agreement with other States.]

(4) In the determination of equivalence, regard shall be had to the following factors:

(a) financial and human resources, including existence of assets within jurisdiction;

(b) trustworthiness of hardware and software systems;

(c) procedures for processing of certificates and applications for certificates and retention of records;

(d) availability of information to the [signers] [subjects] identified in certificates and to potential relying parties;

(e) regularity and extent of audit by an independent body;

(f) the existence of a declaration by the State, an accreditation body or the certification authority regarding compliance with or existence of the foregoing;

(g) susceptibility to the jurisdiction of courts of the enacting State; and

(h) the degree of discrepancy between the law applicable to the conduct of the certification authority and the law of the enacting State.

References to UNCITRAL documents

A/CN.9/454, para. 173;
A/CN.9/446, paras. 196-207 (draft article 19); A/CN.9/WG.IV/WP.73, para. 75;
A/CN.9/437, paras. 74-89 (draft article I); and A/CN.9/WG.IV/WP.71, paras. 73-75.

Remarks

69. Draft article 13 addresses the matters referred to as "cross-border recognition" at the thirty-first session of the Working Group (see A/CN.9/437, paras. 77 and 78). Paragraph (1) is based on a proposal made at the thirty-fourth session of the Working Group (A/CN.9/457, para. 120) that the Working Group might like to consider introducing an article to establish that certificates should not be discriminated against on the basis of the place at which they were issued.

70. Variant A is based on a suggestion for a combination of several paragraphs made at the thirty-second session of the Working Group (see A/CN.9/446, paras. 197-204). As such it sets forth the tests that might be applied in the enacting State in order to recognize the certificates issued by foreign information certifiers, as well as the signatures complying with the laws of another State. Paragraph (4) reflects a general view in the Working Group that parties to commercial and other transactions should be accorded the right to choose the particular information certifier, class of information certifiers or class of certificates that they wished to use in connection with messages or signatures that they received. The reference to parties to commercial and other transactions would include government agencies acting in their commercial capacity.

71. Variant B provides an illustrative list of criteria to be taken into account in assessing the reliability of foreign certificates.

REFERENCES TO NATIONAL LEGISLATION AND OTHER TEXTS

EC Draft Directive

Article 7. International aspects

1. Member States shall ensure that certificates which are issued as qualified certificates to the public by a certification service provider established in a third country are recognized as legally equivalent to certificates issued by a certification service provider established within the European Community:

(a) if the certification service provider fulfils the requirements laid down in this Directive and has been accredited in the context of a voluntary accreditation scheme established in a member State of the European Community; or

(b) if a certification service provider established within the Community, which fulfils the requirements laid down in this Directive, guarantees the certificate; or

(c) if the certificate or the certification service provider is recognized under the regime of a bilateral or multilateral agreement between the Community and third countries or international organizations.

2. In order to facilitate cross-border certification services with third countries and legal recognition of advanced electronic signatures originating in third countries, the Commission will make proposals where appropriate to achieve the effective implementation of standards and international agreements applicable to certification services. In particular and where necessary, it will submit proposals to the Council for appropriate mandates for the negotiation of bilateral and multilateral agreements with third countries and international organizations. The Council shall decide by qualified majority.

Germany

§15 Foreign certificates

(1) Digital signatures which may be checked with a public signature key for which a foreign certificate of another member State of the European Union or of another contracting State of the Treaty in the European Economic Area exists are equivalent to digital signatures under this law, insofar as they demonstrate an equivalent level of security.

(2) Paragraph 1 also applies to other States, insofar as supranational or international agreements concerning the recognition of certificates have been concluded.

Illinois

Article 25. State agency use of electronic signatures and records

Section 25-115. Interoperability

To the extent reasonable under the circumstances, rules adopted by the Department of Central Management Services or a state agency relating to the use of electronic records or electronic signatures shall be

drafted in a manner designed to encourage and promote consistency and interoperability with similar requirements adopted by government agencies of other states and the federal government.

Singapore

Part X. Regulation of certification authorities

Recognition of foreign certification authorities

43. The Minister may by regulations provide that the controller may recognize certification authorities outside Singapore that satisfy the prescribed requirements for any of the following purposes:

(a) the recommended reliance limit, if any, specified in a certificate issued by the certification authority;

(b) the presumption referred to in sections 20*(b)*(ii) [digital signature to be treated as secure electronic signature in certain circumstances] and 21 [presumption of correctness of certificate if accepted by subscriber].

C. Report of the Working Group on Electronic Commerce on the work of its thirty-sixth session: (New York, 14-25 February 2000) (A/CN.9/467) [Original: English]

CONTENTS

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 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). 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 no firm decision as to the form and content of such work had been reached, the Working Group 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 and 157).

3. The Commission endorsed the conclusions reached by the Working Group and entrusted the Working Group with the preparation of draft 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 UNCITRAL Model Law on Electronic Commerce (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.[2]

5. The Working Group began the preparation of the Uniform Rules at its thirty-second session on the basis of a note prepared by the secretariat (A/CN.9/WG.IV/WP.73).

6. At its thirty-first session (1998), 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 that arose 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 realized so far indicated that the draft Uniform Rules on Electronic Signatures were progressively being shaped into a workable structure.

7. The Commission reaffirmed the decision made at its thirty-first session as to the feasibility of preparing such Uniform Rules 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.[3]

8. At its thirty-second session (1999), the Commission had before it the report of the Working Group on the work of its thirty-third (July 1998) and thirty-fourth (February 1999) sessions (A/CN.9/454 and 457). The Commission expressed its appreciation for the efforts accomplished by the Working Group in its preparation of draft uniform rules on electronic signatures. While it was generally agreed that significant progress had been made at those sessions in the understanding of the legal issues of electronic signatures, it was also felt that the Working Group had been faced with difficulties in the building of a consensus as to the legislative policy on which the uniform rules should be based.

9. A view was expressed that the approach currently taken by the Working Group did not sufficiently reflect the business need for flexibility in the use of electronic signatures and other authentication techniques. As currently envisaged by the Working Group, the Uniform Rules placed excessive emphasis on digital signature techniques and, within the sphere of digital signatures, on a specific application involving third-party certification. Accordingly, it was suggested that work on electronic signatures by the Working Group should either be limited to the legal issues of cross-border certification or be postponed altogether until market practices were better established. A related view expressed was that, for the purposes of international trade, most of the legal issues arising from the use of electronic signatures had already been solved in the UNCITRAL Model Law on Electronic Commerce. While regulation dealing with certain uses of electronic signatures might be needed outside the scope of commercial law, the

[1] *Official Records of the General Assembly, Fifty-first Session, Supplement No. 17* (A/51/17), paras. 223 and 224.

[2] Ibid., *Fifty-second Session, Supplement No. 17* (A/52/17), paras. 249-251.

[3] Ibid., *Fifty-third Session, Supplement No. 17* (A/53/17), paras. 207-211.

Working Group should not become involved in any such regulatory activity.

10. The widely prevailing view was that the Working Group should pursue its task on the basis of its original mandate (see above, para. 3). With respect to the need for uniform rules on electronic signatures, it was explained that, in many countries, guidance from UNCITRAL was expected by governmental and legislative authorities that were in the process of preparing legislation on electronic signature issues, including the establishment of public key infrastructures (PKI) or other projects on closely related matters (see A/CN.9/457, para. 16). As to the decision made by the Working Group to focus on PKI issues and PKI terminology, it was recalled that the interplay of relationships between three distinct types of parties (i.e. key holders, certification authorities and relying parties) corresponded to one possible PKI model, but that other models were conceivable, e.g. where no independent certification authority was involved. One of the main benefits to be drawn from focusing on PKI issues was to facilitate the structuring of the Uniform Rules by reference to three functions (or roles) with respect to key pairs, namely, the key issuer (or subscriber) function, the certification function and the relying function. It was generally agreed that those three functions were common to all PKI models. It was also agreed that those three functions should be dealt with irrespective of whether they were in fact served by three separate entities or whether two of those functions were served by the same person (e.g. where the certification authority was also a relying party). In addition, it was widely felt that focusing on the functions typical of PKI and not on any specific model might make it easier to develop a fully media-neutral rule at a later stage (ibid., para. 68).

11. After discussion, the Commission reaffirmed its earlier decisions as to the feasibility of preparing such uniform rules (see above, paras. 3 and 7) and expressed its confidence that more progress could be accomplished by the Working Group at its forthcoming sessions.[4]

12. The Working Group on Electronic Commerce, which was composed of all the States members of the Commission, held its thirty-sixth session in New York from 14 to 25 February 2000. The session was attended by representatives of the following States members of the Working Group: Algeria, Australia, Austria, Brazil, Bulgaria, Cameroon, China, Colombia, Egypt, Finland, France, Germany, Honduras, Hungary, India, Iran (Islamic Republic of), Italy, Japan, Lithuania, Mexico, Nigeria, Romania, Russian Federation, Singapore, Spain, Thailand, United Kingdom of Great Britain and Northern Ireland and United States of America.

13. The session was attended by observers from the following States: Angola, Argentina, Belgium, Bolivia, Canada, Cuba, Czech Republic, Gabon, Indonesia, Iraq, Israel, Kuwait, Kyrgyzstan, Morocco, Netherlands, New Zealand, Norway, Poland, Portugal, Republic of Korea, Saudi Arabia, Sierra Leone, Sweden, Switzerland, Trinidad and Tobago, Tunisia and Turkey.

14. The session was attended by observers from the following international organizations: Economic Commission for Europe, United Nations Conference on Trade and Development (UNCTAD), United Nations Development Programme/ Inter-Agency Procurement Services Office (UNDP/IAPSO), United Nations Educational, Scientific and Cultural Organization (UNESCO), United Nations Industrial Development Organization (UNIDO), World Intellectual Property Organization (WIPO), African Development Bank, Commonwealth secretariat, European Commission, Organisation for Economic Cooperation and Development (OECD), Organization of the American States (OAS), Cairo Regional Centre for International Commercial Arbitration, Commercial Finance Association (CFA), Electronic Frontier Foundation Europe, Grupo Latinoamericano de Abogados para el Derecho del Comercio Internacional (GRULACI), Inter-American Bar Association, International Bar Association (IBA), International Chamber of Commerce (ICC), Internet Law and Policy Forum (ILPF), Society for Worldwide Interbank Financial Telecommunication (SWIFT), World Association of Former United Nations Interns and Fellows (WAFUNIF), *Union internationale des avocats* and *Union internationale du notariat latin* (UINL).

15. The Working Group elected the following officers:

Chairman: Mr. Jacques GAUTHIER (Canada, elected in his personal capacity)

Rapporteur: Mr. Aly Sayed KASSEM (Egypt)

16. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.IV/WP.83); note by the secretariat containing revised draft uniform rules on electronic signatures (A/CN.9/WG.IV/WP.84).

17. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Legal aspects of electronic commerce: draft uniform rules on electronic signatures.
4. Other business.
5. Adoption of the report.

I. DELIBERATIONS AND DECISIONS

18. The Working Group discussed the issue of electronic signatures on the basis of the note prepared by the secretariat (A/CN.9/WG.IV/WP.84). The deliberations and conclusions of the Working Group with respect to those issues are reflected in section II below.

19. After discussion of draft articles 1 and 3 to 12, the Working Group adopted the substance of those draft articles and referred them to a drafting group to ensure consistency between the provisions of the Uniform Rules. The Working Group subsequently reviewed the report of the drafting group, which is contained in the annex to this report.

20. The secretariat was requested to prepare a draft guide to enactment of the provisions adopted. Subject to approval by the Commission, the Working Group recommended that draft articles 2 and 13 of the Uniform Rules, together with the guide to enactment, be reviewed by the Working Group at a future session.

[4]Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), paras. 308-314.

II. DRAFT UNIFORM RULES ON ELECTRONIC SIGNATURES

A. General remarks

21. At the outset, the Working Group exchanged views on current developments in regulatory issues arising from electronic commerce, including adoption of the Model Law, electronic signatures and public key infrastructure (referred to here as "PKI") issues in the context of digital signatures. These reports, at the governmental level, confirmed that addressing electronic commerce legal issues was recognized as essential for the implementation of electronic commerce and the removal of barriers to trade. It was reported that a number of countries had introduced recently, or were about to introduce, legislation either adopting the Model Law or addressing related electronic commerce facilitation issues. A number of those legislative proposals also dealt with electronic (or in some cases, specifically digital) signature issues.

B. Consideration of draft articles

Article 1. *Sphere of application*

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

"These Rules apply where electronic signatures are used in the context* of commercial** activities. They do not override any rule of law intended for the protection of consumers.

"*The Commission suggests the following text for States that might wish to extend the applicability of these Rules:

"These Rules apply where electronic signatures are used, except in the following situations: [...]".

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

23. The Working Group generally agreed that draft article 1 as currently drafted was acceptable. It was adopted in substance, subject to possible reconsideration after review of the text by a drafting group to ensure consistency between the provisions of the Uniform Rules.

24. After discussion of draft article 1, the Working Group decided to postpone consideration of the definitions in draft article 2 until it had completed its review of the substantive provisions of the Uniform Rules.

Article 3. *[Technology neutrality] [Equal treatment of signatures]*

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

"None of the provisions of these Rules shall be applied so as to exclude, restrict, or deprive of legal effect any method [of *electronic* signature] [that satisfies the requirements *referred to in article 6(1) of these Rules*][*which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement*] [*or otherwise meets the requirements of applicable law*]."

26. An initial concern was raised as to the need for an article along the lines of draft article 3. It was pointed out that the original intention of the draft article was to ensure that signature technologies that could be demonstrated to meet the requirements of draft article 6 (1) should not be discriminated against, even if they could not be considered to be within the definition of enhanced electronic signatures. It was suggested that, if the distinction between electronic signatures and enhanced electronic signatures was not maintained in the Uniform Rules, draft article 3 might not be required

27. As to the title of draft article 3, one view was that "Technology neutrality" was preferable since it stated clearly a principle upon which it was agreed the Uniform Rules should be based. In support of that view, it was suggested that the phrase "Equal treatment" might lead to some confusion with the principle of non-discrimination set forth in draft article 13. Another view was that neither title properly described the content of draft article 3, which was that all technologies were to be given the same opportunity to satisfy the requirements of draft article 6. After discussion, the Working Group decided to combine both alternatives.

28. With regard to the first text in square brackets in draft article 3, "[of electronic signature]", it was suggested that the Uniform Rules should refer consistently to either "a method" or "an electronic signature", but not to both, as that would not be consistent with the Model Law. Another view was that the reference should be to an "electronic signature", as that was the subject of the Uniform Rules. As a compromise, it was proposed that draft article 3 should refer to "any method of creating an electronic signature". That proposal received general support.

29. With regard to the second set of words in square brackets, there was general agreement that the formulation "that satisfies the requirements referred to in article 6 (1) of these Rules" was preferable to the formulation which set out in full the terms of article 7 (1) *(b)* of the Model Law, as those words were already included in draft article 6 and did not need to be repeated in draft article 3.

30. Some concerns were expressed about the meaning of the final words in square brackets, "[or otherwise meets the requirements of applicable law.]". One view was that those words should be retained as they provided a degree of flexibility to the draft article and recognized the possibility of a standard which was lower than that set forth in article 7 of the Model Law (and draft article 6 of the Uniform

Rules). A contrary view was that, if the parties agreed to use a higher standard than that approved by applicable law (assuming applicable law to reflect the terms of article 7 of the Model Law), it would not be covered by the current draft of article 3. Another view was that those words were too narrow and did not take sufficient account of the importance of trade practices and usages that might be relevant where, for example, a self-regulatory approach was adopted towards electronic signatures. A contrary view was that those trade practices and usages, if relevant, would be included within, or reflected by, applicable law and if they were not, they should have no application in the context of draft article 3. A further suggestion was that the reference to applicable law could be deleted, since any State adopting the Uniform Rules would always have to consider how the Uniform Rules would relate to existing law, which would clearly be the applicable law referred to in the draft article.

31. Another issue of concern with respect to draft article 3 was its relationship to draft article 5 and the concept of party autonomy. It was suggested that the opening words "None of the provisions of these Rules" could be construed as excluding the ability of parties to agree to something other than the requirements of draft article 6 (1), whether more or less than that standard. A contrary view was that that was not a correct interpretation of the two draft articles and draft article 3 would clearly be subject to draft article 5 unless otherwise stated in draft article 3. It was pointed out that the question of party agreement in any event was included in draft article 6(1), which specifically referred to the need to consider all circumstances "including any relevant agreement" and could be included within the reference to applicable law. It was also suggested that that issue was one of drafting, not of substance, and could be addressed by reversing the order of draft articles 3 and 5, by including appropriate wording in either draft article 3 or draft article 5, or by ensuring that the relationship between draft articles 3 and 5 was explained clearly in a guide to enactment.

32. After discussion, the Working Group adopted the following text of the draft article subject to possible reconsideration after review of the text by a drafting group to ensure consistency between the various provisions of the Uniform Rules:

> "None of these Rules, except article 5, shall be applied so as to exclude, restrict or deprive of legal effect any method of creating an electronic signature that satisfies the requirement referred to in article 6(1) of these Rules or otherwise meets the requirements of applicable law."

Article 4. *Interpretation*

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

> "(1) In the interpretation of these Uniform Rules, regard is to be had to their international origin and to the need to promote uniformity in their application and the observance of good faith.
>
> "(2) Questions concerning matters governed by these Uniform Rules which are not expressly settled in them are to be settled in conformity with the general principles on which these Uniform Rules are based."

34. The substance of draft article 4 was found generally acceptable. It was adopted subject to review of the text by a drafting group to ensure consistency between the various provisions of the Uniform Rules and the various language versions.

35. In the context of the discussion of draft article 4, it was observed that the Uniform Rules should provide indication as to the principles on which they were based. For example, it was generally agreed that the principle of technology neutrality expressed in draft article 3 should be listed among the principles referred to in draft article 4. It was suggested that a preamble to the Uniform Rules, to be discussed for possible inclusion at a later stage, would be an appropriate place for stating such principles.

Article 5. *[Variation by agreement] [Party autonomy] [Freedom of contract]*

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

> "These Rules may be derogated from or [their effect may be] varied by agreement, unless otherwise provided in these Rules or in the law of the enacting State."

37. The Working Group discussed the title of draft article 5. It was generally agreed that, for reasons of consistency with article 4 of the Model Law, the title "Variation by agreement" should be adopted. "Party autonomy" and "Freedom of contact" were generally regarded as mere restatements of the general principles underpinning draft article 5.

38. As to the way in which the principle of party autonomy was expressed in draft article 5, various suggestions of a drafting nature were made. One suggestion was that the conjunction "and" was preferable to "or" to indicate that both derogation from and variation of the Uniform Rules were envisaged by the draft provision. Another suggestion was that reference should be made to "variation by agreement expressed or implied". After discussion, it was generally agreed that, to the extent possible, the wording of draft article 5 should be kept in line with article 6 of the United Nations Convention on Contracts for the International Sale of Goods (hereinafter referred to as "the United Nations Sales Convention"). Appropriate explanations regarding variation by way of an implied agreement might be included in a guide to enactment of the Uniform Rules.

39. A suggestion was made that the Uniform Rules might include also wording drawn from articles 9 and 11 of the United Nations Sales Convention. The widely prevailing view, however, was that such provisions, which were needed in the text of an international convention, would be superfluous in uniform rules.

40. With respect to the words "unless otherwise provided in these Rules", it was generally agreed that the matter might need to be reconsidered after the Working Group had completed its review of the draft articles. Pending a decision as to whether the Uniform Rules would contain any mandatory provision, the words "unless otherwise provided in these Rules" should be placed within square brackets.

41. As to the words "unless otherwise provided in the law of the enacting State", the view was expressed that redrafting was necessary to avoid creating the impression that enacting States were encouraged to establish mandatory legislation limiting the effect of party autonomy with respect to electronic signatures. It was suggested that the words "unless the agreement is not otherwise enforceable under the law of the enacting State" might be used. Another suggestion was to express the principle of party autonomy without restriction and to introduce a new paragraph along the following lines: "The provisions of this article do not apply to the following: ...".

42. It was observed that, in some legal systems, the notion of an agreement being unenforceable would adequately cover all cases where public policy, mandatory law or court discretion might limit the effectiveness of a contract. However that notion was not readily used in all legal systems. It was generally agreed that the words "unless that agreement would not be valid or effective under the law of the enacting State" were more appropriate.

43. After discussion, it was decided that, subject to review by a drafting group, draft article 5 should read along the lines of: "These Rules may be derogated from or their effect may be varied by agreement, unless [otherwise provided in these Rules or] the agreement would not be valid or effective under the law of the enacting State".

Article 6. *[Compliance with requirements for signature] [Presumption of signing]*

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

"(1) Where the law requires a signature of a person, that requirement is met in relation to a data message if [*a method*] [*an electronic signature*] is used which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

"(2) Paragraph (1) applies whether the requirement referred to therein is in the form of an obligation or whether the law simply provides consequences for the absence of a signature."

Variant A

"(3) It is presumed that [a method] [an electronic signature] is reliable for the purpose of satisfying the requirement referred to in paragraph (1) if that method ensures that:

(a) the data used for the creation of an electronic signature are unique to the holder of the signature [creation] device within the context in which they are used;

(b) the holder of the signature [creation] device [has] [had at the relevant time] sole control of that device;

(c) the electronic signature is linked to the [information] [the data message or the part of that message] to which it relates [in a manner which guarantees the integrity of that information];

(d) the holder of the signature [creation] device is objectively identified within the context [in which the device is used] [of the data message].

Variant B

"(3) In the absence of proof to the contrary, the use of an electronic signature is presumed to prove:

(a) that the electronic signature meets the standard of reliability set out in paragraph (1);

(b) the identity of the alleged signer; and

(c) that the alleged signer approved the information to which the electronic signature relates.

"(4) The presumption in paragraph (3) applies only if:

(a) the person who intends to rely on the electronic signature notifies the alleged signer that the electronic signature is being relied upon [as equivalent to the handwritten signature of the alleged signer] [as proof of the elements listed in paragraph (3)]; and

(b) the alleged signer fails to notify promptly the person who issues a notification under subparagraph *(a)* of the reasons for which the electronic signature should not be relied upon [as equivalent to the handwritten signature of the alleged signer] [as proof of the elements listed in paragraph (3)].

Variant C

"(3) In the absence of proof to the contrary, the use of an electronic signature is presumed to prove:

(a) that the electronic signature meets the standard of reliability set out in paragraph (1);

(b) the identity of the alleged signer; and

(c) that the alleged signer approved the information to which the electronic signature relates.

"[(4)][(5)] The provisions of this article do not apply to the following: [...]."

General remarks

45. There was general agreement in the Working Group that the purpose of draft article 6 was to build upon article 7 of the Model Law and provide guidance as to how the test of reliability in article 7(1)*(b)* could be satisfied. It was also agreed that the means of achieving that result should be consistent with the terms of the Model Law.

Paragraphs (1) and (2)

46. There was considerable support for paragraphs (1) and (2) of draft article 6 as currently drafted, although some support was also expressed in favour of reproducing in draft article 6(1) the entire text of article 7(1) of the Model Law, as proposed in paragraph 41 of the note by the secretariat (A/CN.9/WG.IV/WP.84). It was suggested that quoting more extensively from the Model Law would emphasize that the main goal of paragraph (1) was to deal with the case where any type of electronic signature (including "non-enhanced" methods of authentication) was

used for signing purposes (i.e. with intent to create a functional equivalent of a handwritten signature). Since the substance of article 7(1)*(a)* of the Model Law was already included in the definition of "electronic signature" in draft article 2*(a)* of the Uniform Rules, it was noted that that approach would require the definition to be reconsidered.

47. It was widely felt, however, that repetition of the entire text of article 7 was not necessary in draft article 6, principally on the basis that the resulting text would be unnecessarily long and complex, and that the substance of article 7(1)*(a)* could be retained in the definition of "electronic signature" in the Uniform Rules.

48. As a matter of drafting, there was general support for including the reference to "an electronic signature" (currently in square brackets) as opposed to "a method". It was pointed out that since the subject of the Uniform Rules was electronic signatures, they should be referred to directly in draft article 6. A proposal that those two phrases could be merged to reflect the text agreed in respect of draft article 3, "a method of creating an electronic signature", was not widely supported.

49. A proposal was made that draft article 6 should be based upon, and not detract from, three principles: first, the reliability test set forth in article 7(1)*(b)* of the Model Law; secondly, the importance of party agreement, as currently reflected in draft article 5 and the last words of draft article 6(1); and thirdly, the possibility that applicable law could mandate the use of a particular form of signature technique, as currently reflected in draft article 8. It was also proposed that the text referred to in paragraph 42 of the note by the secretariat (A/CN.9/WG.IV/WP.84) under which "the legal consequences of the use of a signature shall apply equally to the use of electronic signatures" should also be incorporated. The following text was suggested to reflect those principles:

"6(1) Where the law requires a signature of a person, that requirement is met in relation to a data message if:

(a) an electronic signature is used which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all relevant circumstances; or

(b) the parties to a contract agree on the form of electronic signature to be used and do, in fact, use that form of electronic signature; or

(c) the terms of the applicable law mandate a form of electronic signature and that form of electronic signature is, in fact, used.

"6(2) Paragraph (1) applies whether the requirement referred to therein is in the form of an obligation or whether the law simply provides consequences for the absence of a signature.

"6(3) The legal consequences of the use of a signature shall apply equally to the use of an electronic signature which meets the requirements of paragraph (1)."

50. With reference to the drafting of that proposal, one concern expressed was that the use of the word "contract" in proposed paragraph (1)*(b)* was too narrow and did not reflect the broader concept included in the current formulation of draft article 5, that is, one which did not restrict the nature of the agreement referred to and did not mention the parties between whom that agreement might be reached. It was also suggested that paragraph (2) should include, in addition to a reference to "mandating" the use of a form of electronic signature, a reference to applicable law "permitting" the use of a particular form of signature. Some concern was also expressed as to the reference to a "form of signature" and it was clarified that what was intended was a "method" of signature.

51. As to the substance of the proposal, it was suggested that paragraph (1)*(b)* should be left to draft article 5, since it might lead to some confusion if included within draft article 6 and result in a more narrow interpretation of the principle of party autonomy than was intended by the Working Group. It was also questioned whether paragraph (1)*(b)* would allow parties to use a method of signature that was more reliable than a method which they had previously agreed upon. To address that issue, it was proposed that the paragraph should refer to "a method at least as reliable as the method agreed upon". It was also suggested that paragraph (1)*(c)* did not need to be stated, since it was clear that any State could adopt such an approach if it chose to do so, and that paragraph (3) was superfluous as it was simply a restatement of the effect of paragraph (1). The concern was also expressed that the reference to the consequences of the use of a signature might lead to a broad interpretation which might not be appropriate with respect to all the consequences of the use of a handwritten signature. By way of illustration, the example was given of certain evidentiary provisions relating to the proof of a handwritten signature which could not easily be transposed for electronic signatures.

52. It was observed that the proposal, particularly paragraph (1)*(c)*, might be useful in addressing the situation where the rule of conflicts suggested that the applicable law would be law other than that of the enacting State. It was suggested that if all three subparagraphs of paragraph (1) were not to be retained, the draft article could be interpreted as presupposing that all countries had adopted the Model Law, which might not be the case. For that reason, it was suggested that paragraph (1)*(c)* should be retained in order to address possible questions of conflict. After further discussion, however, the proposal did not receive wide support.

53. The Working Group agreed that paragraphs (1) and (2) of draft article 6 as currently drafted should be adopted, with the phrase "an electronic signature" subject to possible reconsideration after review by a drafting group to ensure consistency between the provisions of the Uniform Rules. The Working Group proceeded to consider the definition of "electronic signature" set forth in draft article 2*(a)*.

Definition of "electronic signature"—draft article 2(a)

54. The Working Group considered whether the definition of "electronic signature" in the Uniform Rules should follow drafting which reflected the terms of article 7 of the Model Law, or whether it might be possible to adopt a different formulation.

55. It was proposed in draft article 2*(a)*: that the words in square brackets referring to "data in electronic form" should be adopted in preference to the words "any method in relation to a data message", with the phrase "attached to" substituted for "affixed to"; and that the remainder of the definition following the words currently in square brackets should read "that identifies the signatory and purports to indicate the signatory's intention to approve or associate itself with the information contained in the data message". It was also proposed that, since the term "identification" could be broader than mere identification of a person by name, the following sentence should be added to the definition by way of clarification: "For the purposes of this definition, identification of the signatory includes distinguishing him or her, by name or otherwise, from any other person."

56. The view was expressed, however, that drafting which reflected the terms of the Model Law should be closely followed, since adopting the language proposed in paragraph 55 above amounted to unnecessary modification of the Model Law and did not assist the Working Group in addressing the key purpose of draft article 6, which was currently set forth in the variants of paragraph (3). It was also pointed out that the question of the meaning of "identification" had been raised in paragraph 32 of the note by the secretariat (A/CN.9/WG.IV/WP.84) and might appropriately be reflected in a guide to enactment of the Uniform Rules.

57. After discussion, the Working Group adopted the following text of the definition, subject to possible reconsideration to ensure consistency between the provisions of the Uniform Rules:

> "Electronic signature" means any method that is used to identify the signature holder in relation to the data message and indicate the signature holder's approval of the information contained in the data message."

58. The Working Group agreed that the meaning of the term "identification" should be addressed in a guide to enactment along the lines of the last sentence of paragraph 55 above and paragraph 32 of the note by the secretariat (A/CN.9/WG.IV/WP.84).

Paragraph (3)

59. General support was expressed in favour of variant A.

Opening words

60. It was widely felt that paragraph (3) was an essential provision if the Uniform Rules were to meet their goal of providing more certainty than readily offered by the Model Law as to the legal effect to be expected from the use of particularly reliable types of electronic signatures. It was recalled that paragraph (1), to the extent it reproduced article 7(1) of the Model Law, dealt with the determination of what constituted a reliable method of signature in the light of the circumstances. Such a determination could only be made under article 7 of the Model Law by a court or other trier of fact intervening ex post, possibly long after the electronic signature had been used. In contrast, the benefit expected from the Uniform Rules in favour of certain techniques, which were recognized as particularly reliable, irrespective of the circumstances in which they were used, was to create certainty (through either a presumption or a substantive rule), at or before the time any such technique of electronic signature was used (ex ante), that using such a recognized technique would result in legal effects equivalent to those of a handwritten signature (A/CN.9/WG.IV/WP.84, para. 43).

61. Divergent views were expressed as to the form in which the rule contained in paragraph (3) should be expressed. One view was that establishing a presumption was the most appropriate way of drawing attention to the expected result of paragraph (3), namely to establish certainty with respect to the use of a certain signature technique by requiring the party who wished to challenge the type of electronic signature envisaged in paragraph (3) to produce evidence as to the lack of reliability of that signature. Another view was that establishing a presumption might raise difficult questions regarding the level of the presumption and the means by which it could be rebutted. It was observed that the Uniform Rules might not be an appropriate instrument to attempt any harmonization of procedural law. Yet another view was that paragraph (3) should not be in the form of a rule, whether a rule of evidence or a substantive rule, but that it should merely list a number of factors to be taken into account when assessing the reliability of a given signature technique. That view was objected to on the grounds that, if paragraph (3) were merely to list a number of factors, it would add little value or certainty to article 7 of the Model Law, which was already accompanied by a list of factors in paragraph 58 of the Guide to Enactment.

62. The prevailing view was that, in order to provide certainty as to the legal effect resulting from the use of what might or might not be called an "enhanced electronic signature" under draft article 2, paragraph (3) should not merely list certain factors to be taken into account when assessing the reliability of an electronic signature. Instead, it should expressly establish the legal effects that would result from the conjunction of certain technical characteristics of an electronic signature. As to how those legal effects would be established, it was agreed that enacting States, depending on their law of civil and commercial procedure, should be free to adopt a presumption or to proceed by way of a direct assertion of the linkage between certain technical characteristics and the legal effect of a signature. It was agreed that wording along the following lines should be adopted:

> "An electronic signature is considered to be reliable for the purpose of satisfying the requirements referred to in paragraph (1) if ..."

It was suggested that additional words might be necessary to avoid the possible misinterpretation of paragraph (3) as affecting the operation of the general rule contained in paragraph (1). While paragraph (3) would appropriately offer the benefit of certainty (which was also described as establishing a "safe haven" rule), it should not prevent parties from demonstrating that electronic signatures that did not fall under paragraph (3) could also satisfy the requirements in paragraph (1). Another suggestion was that, in order to avoid creating an irrebuttable presumption, paragraph (3) should be made subject to evidence being

produced to demonstrate that a given use of an electronic signature under paragraph (3) should not in fact result in that electronic signature being treated as reliable. Those two suggestions were adopted by the Working Group. The matter was referred to the drafting group.

Variant A, paragraph 3(a)

63. Some doubts were expressed about the signature creation device being "unique" to the signature device holder. From a technical point of view it was suggested that the device could be "uniquely linked", but not "unique"; the linkage between the data used for creation of the signature and the device holder was the essential element. The following formulation was suggested for subparagraph *(a)*:

"*(a)* the data used for creation of the electronic signature are linked, within the context in which they are used, to the signatory and to no other person".

64. Concern was expressed that subparagraph *(a)* might mean that the signature device could be linked to different signatories in different contexts.

65. As a matter of drafting, it was proposed that the opening phrase of subparagraph *(a)* should be "the means of creating the electronic signature". The Working Group adopted subparagraph *(a)* as proposed (see para. 63 above) with that amendment.

Variant A, paragraph (3)(b)

66. One concern expressed in relation to the phrase "sole control" was how it would affect the ability of the holder of the signature device to authorize another person to use the signature on the holder's behalf. A related concern was use of the signature device in the corporate context where the corporate entity would be the signature holder but would require a number of persons to be able to sign on its behalf. It was suggested that that issue could be addressed by deleting the word "sole" and including, in addition to the reference to the holder of the signature device, the words "and any authorized signatory".

67. A further view in support of the deletion of "sole" was that it was a restrictive requirement which might exclude existing business applications such as the one where the signature device existed on a network and was capable of being used by a number of people. It was pointed out, however, that that situation could still operate within the concept of "sole control"; the network would presumably relate to a particular entity which would be the signature holder and thus capable of maintaining control over it. If that was not the case, and the signature device was widely available, it should not be covered by the rules.

68. In support of retaining the concept of "sole", the view was expressed that it was essential to ensure that the signature device was capable of being used by only one person at any given time, principally the time at which the signature was created, and not by some other person as well. It was suggested that the question of agency or authorized use of the signature device should be addressed in the definition of "signature holder", not in the substance of the rules. To address the concerns expressed, the following text was suggested:

"*(b)* the means of creating the electronic signature was, at the relevant time, under the control of the signatory and no other person".

69. Some concern was expressed as to the meaning of the words "at the relevant time". It was pointed out that it was essential to retain this concept because the means of creating the signature might include both software and hardware, and the latter might be used by a number of persons to create signatures, so that it needed to be made clear that the signatory had control of those means at the time the signature was created. It was suggested that this could be clarified by stating that the relevant time was the "time of signing". Another suggestion was that since the time of generation of the signature might also be a "relevant time", the phrase could read: "at the time the signature was both generated and used". It was pointed out that, although it might be possible for the time of signing to differ from technology to technology, it would always be a question of fact.

70. A contrary view was that since it would be difficult to prove the exact time of signing, the concept of "relevant time" should be deleted. In response, it was pointed out that deleting any reference to time merely begged the question of whether the signatory had control of the means of creating the signature at all times relevant to the issue in question.

71. After discussion, the Working Group agreed to adopt the phrase "at the time of signing".

Variant A, paragraph (3)(c)

72. The view was expressed that it was essential for paragraph (3)*(c)* to include the notion of a guarantee of integrity of the information in the data message, since a signature which provided such a guarantee would clearly be a reliable signature within the meaning of draft article 6(1). Where a signature was attached to a document, the integrity of the document and the integrity of the signature were so closely related that it was not possible to conceive of one without the other. In other words, where a signature was used to sign a document, the idea of the integrity of the document was inherent in the use of the signature. It was also noted that the idea of the integrity of the document was closely linked to the use of the signature to signify approval of the content of the document.

73. A contrary view, based upon the distinction drawn in the Model Law between articles 7 and 8, was that, although some technologies provided both authentication (article 7) and integrity (article 8), those concepts could be seen as distinct legal concepts and were treated as such in the Model Law. Since a handwritten signature provided neither a guarantee of the integrity of the document to which it was attached nor a guarantee that any change made to the document would be detectable, the functional equivalence approach required that those concepts should not be added to paragraph (3)*(c)*. The purpose of paragraph (3)*(c)* was to set forth the criteria to be met in order to demonstrate that a particular method of signature was reliable enough to satisfy a requirement of law for a signature. It was suggested, in support of that view, that requirements of law for

a signature could be met without having to demonstrate the integrity of the document. It was noted, however, that the issue of integrity should not be deleted from the Uniform Rules, but should be addressed in the context of draft article 7; in that way signatures could satisfy draft article 6 or draft article 7, or both, depending upon what requirement of law was to be satisfied.

74. It was observed that including the requirement for integrity of the information in draft article 6 suggested the use of one particular technology, which would be inconsistent with the principle of technology neutrality. It was suggested that the use of one particular technology would be too restrictive and would hamper, rather than promote, the use of electronic signatures in a number of countries. In addition, it might create a signature which was more reliable than a handwritten signature and thus go beyond the concept of functional equivalence, possibly prejudicing the use of handwritten signatures.

75. The view was expressed that, although the link between the signature and the data message was clearly required and integrity of the signature was important, those requirements could be distinguished from a requirement of integrity of the information in the data message. A contrary view was that integrity of the signature was not an issue that needed to be addressed and, in any event, could not be separated from a consideration of the integrity of the signed information. It was proposed, however, that the integrity of the signature could be addressed as follows:

"*(c)* the electronic signature is linked to the information to which it relates in a manner such that any alteration to the electronic signature, made after its creation, is detectable".

76. That proposal received general support.

77. The view was expressed that, as an alternative to a general requirement that the signature technique used must be able to guarantee the integrity of the document, the notion of integrity of the document could be included as a criterion to be satisfied only in circumstances where that guarantee was the focus of the signature requirement. One proposal was made to address the integrity of the signature and of the information in the data message as separate ideas, by adding words "or to the data message" after the words "to the electronic signature". A further proposal was that the issue of detecting an alteration of the signature should be included in paragraph (3) as proposed in paragraph 75 above, with a separate, additional article reading as follows:

"Where the law requires a signature to give assurance as to the integrity of information in a document, that requirement is met in relation to a data message by the use of an electronic signature which is linked to the data message in such a manner that any subsequent alteration of the information in the data message would be detectable".

78. The view was expressed that that provision should not be included in a separate provision because it ought to be clear that draft article 6(3) would not be met if one of the reasons for the requirement of a signature was to provide assurance as to the integrity of the document. It was observed that the words "where the law requires a signature to give assurance" might require an inquiry into the reasoning behind the requirement, which would invariably prove difficult. To resolve that difficulty, the provision should be formulated in the negative, along the following lines, and be included as a second sentence in paragraph (3)*(c)*, as follows:

"*(c)* the electronic signature is linked to the information to which it relates in a manner such that any alteration to the electronic signature, made after its creation, is detectable. Where the law requires a signature to support the integrity of a signed document, that requirement of integrity is not satisfied unless the electronic signature permits detection of any alteration of the document".

79. Support was expressed in favour of those proposals on the basis that they might satisfy both the situations where integrity of the document was required and those where the signature was required without any reference to integrity. It was suggested, however, that the provision might be more effective if formulated as a proviso, as follows:

"*(c)* the electronic signature is linked to the information to which it relates in a manner such that any alteration to the electronic signature, made after its creation, is detectable, provided that, where the purpose of the legal requirement for a signature is to provide assurance as to the integrity of the information in the document, it shall be necessary to establish also that the electronic signature is linked to the data message in a manner ensuring that any alteration made to the data message after creation of the electronic signature is detectable".

80. As between the two proposals, support was expressed in favour of the form drafted as a proviso because it focused upon the purpose of the legal requirements being to provide integrity rather than upon situations where the law required the signature to assure integrity, which might be more difficult to ascertain. It was suggested, however, that the reference should be to "a purpose" rather than "the purpose". A suggestion to delete the reference to a "requirement of law" and simply to refer to any situation where a signature was used for the purpose of assuring integrity was not supported. It was pointed out that, since the overall purpose of draft article 6 was to address requirements of law for a signature, that limitation could not be removed from paragraph (3)*(c)*. After discussion of a number of other suggestions of a drafting nature, the following text was adopted:

"*(c)* any alteration to the electronic signature, made after its creation, is detectable and, where a purpose of the legal requirement for a signature is to provide assurance as to the integrity of the information in the data message, any alteration made to the data message after the time of signing is detectable;"

Variant A, paragraph (3)(d)

81. Some concern was expressed as to the meaning of the word "objective". One view was that that standard of identification might be rather difficult to satisfy in all cases, especially where the context or the content of the signature might be sufficient without requiring what would amount to "objective" or external confirmation of the identity of the signature holder. Another view was that the importance of the requirement was not the actual identification of the

signature holder, but that the technology should be capable of objectively identifying the signature holder.

82. The view was expressed that the inclusion in the definition of "electronic signature" of a requirement that the signature be used to identify the signature holder made the inclusion of paragraph (3)*(d)* in article 6 unnecessary. In support of that view it was noted that, while the idea of objective identification had been included in some national electronic signature laws, that had been in the context of presumptions of identity, not in relation to the reliability of the method of signature. It was noted that it would be hard to envisage a situation where subparagraphs *(a)* to *(c)* of paragraph (3) were satisfied by a particular method of signature which did not also satisfy subparagraph *(d)*.

83. After discussion, the Working Group agreed that paragraph (3)*(d)* should be deleted.

84. At the close of the discussion of paragraph (3), the view was expressed that draft article 6 might need to be redrafted to indicate that any presumption arising from the combination of the elements listed in subparagraphs *(a)* to *(c)* might also arise from determination by the parties in any relevant agreement that a given signature technique would be treated among themselves as a reliable equivalent of a handwritten signature. Some support was expressed in favour of that view. Various drafting suggestions were made in that respect. One suggestion, based on article 4 of the Model Law, was to insert the following wording as a separate paragraph or as a subparagraph of paragraph (3): "This article does not affect any right that may exist to establish by agreement the reliability of an electronic signature to satisfy the requirement referred to in paragraph (1)." Another suggestion, geared to the situation where parties would agree on the use of a standard higher than the one expressed in paragraph (3), was to introduce language along the following lines: "Nothing in paragraph (3) shall prevent enforceability as between the parties of standards of reliability higher than those referred to in paragraph (1)." A related proposal read as follows: "Nothing in paragraph (3) shall permit a person to satisfy the requirement referred to in paragraph (1) where that person has agreed to meet a higher standard of reliability which has in fact been met." The last two suggestions were objected to on the grounds that the issues of contractual liability faced by a party who failed to meet a higher standard to which it had agreed should not be dealt with in draft article 6, but under the law governing contractual liability outside the Uniform Rules.

85. The prevailing view was that draft article 5 sufficiently expressed the possibility for parties to derogate from the provisions of the Uniform Rules. It was agreed that renewing the expression of party autonomy in the context of draft article 6 might be repetitious and inappropriately suggest that parties were free to modify, as between themselves, any mandatory requirement of law with respect to the use of a signature.

86. Yet another suggestion was made to introduce additional wording in draft article 6 to address the situation where the reliability of an electronic signature would be presumed as a result of a determination by a State authority under draft article 8. It was generally felt that such a situation was sufficiently dealt with in draft article 8. That suggestion was not supported by the Working Group.

Paragraph (4)

87. There was general agreement that a provision along the lines of paragraph (4), based on a similar provision in various articles of the Model Law ("The provisions of this article do not apply to the following: ..."), should be included in draft article 6.

Article 7. *[Presumption of original]*

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

"(1) A data message is presumed to be in its original form where, in relation to that data message, [a method] [an electronic signature] [within article 6] is used which:

(a) provides a reliable assurance as to the integrity of the information from the time when it was first generated in its final form, as a data message or otherwise; and

(b) where it is required that information be presented, that information is capable of being displayed to the person to whom it is to be presented;

"(2) The provisions of this article do not apply to the following: [...]."

89. In view of the decision to deal in draft article 6 (3) with the situation where an electronic signature was used to meet a legal requirement for integrity of the information contained in a document, it was generally agreed that it would be superfluous to address that same situation from the perspective of the "originality" of the document. After discussion, the Working Group decided that draft article 7 should be deleted.

Article 8. *Satisfaction of articles 6 and 7*

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

"Variant A

"(1) *[The organ or authority specified by the enacting State as competent]* may determine which methods satisfy the requirements of articles 6 and 7.

"(2) Any determination made under paragraph (1) shall be consistent with recognized international standards.

"Variant B

"(1) One or more methods of electronic signature may be determined as satisfying the requirements of articles 6 and 7.

"(2) Any determination made under paragraph (1) shall be consistent with recognized international standards."

91. Some support was expressed in favour of variant B on the grounds that it did not emphasize the role of State authorities in making a determination as to which types of electronic signatures would be presumed to satisfy legal

requirements for signatures. The prevailing view, however, was that the discussion should proceed on the basis of variant A, which was more descriptive of the role necessarily played by the enacting State in establishing or recognizing any entity that might validate the use of electronic signatures or otherwise certify their quality. In order not to suggest that such entities would always have to be established as State authorities, it was generally agreed that the opening words of paragraph (1), "[The organ or authority specified by the enacting State]", should be replaced by wording along the following lines: "[The person, organ or authority, whether public or private, specified by the enacting State]".

92. A question was raised as to whether the reference in draft article 8 to draft article 6 should be made more specific. Support was expressed for referring to "the requirement of article 6(1)", since paragraph (1) of article 6 was said to contain the broadest expression of a legal requirement for a signature. The prevailing view, however, was that draft article 8 should not refer to any specific paragraph of draft article 6. When making a determination with respect to the satisfaction of requirements for signature, the competent persons or authorities should be free to refer to article 6(1) or to article 6(3).

93. With respect to paragraph (2), concern was expressed as to the meaning of the words "recognized standards". Consistent with the interpretation suggested at its previous session (see A/CN.9/465, para. 94), the Working Group decided that the word "standard" needed to be interpreted in a broad sense, which would include industry practices and trade usages, legal texts emanating from international organizations, as well as technical standards. It was also decided that the guide to enactment of the Uniform Rules should make it clear that the possible lack of relevant standards should not prevent the competent persons or authorities from making the determination referred to in paragraph (1).

94. It was suggested that an additional paragraph should be introduced in draft article 8 to make it abundantly clear that the purpose of the draft article was not to interfere with the normal operation of the rules of private international law. It was stated that, in the absence of such a provision, draft article 8 might be misinterpreted as encouraging enacting States to discriminate against foreign electronic signatures on the basis of non-compliance with the rules set forth by the relevant person or authority under paragraph (1). The following text was proposed: "(3) Nothing in this article affects the operation of the rules of private international law." That proposal was generally supported.

95. After discussion, the Working Group adopted draft article 8 subject to the above changes and referred it to the drafting group.

Article 9. *Responsibilities of the signature device holder*

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

"(1) Each signature device holder shall:

(a) exercise reasonable care to avoid unauthorized use of its signature device;

(b) notify appropriate persons without undue delay if:

(i) the signature device holder knows that the signature device has been compromised; or

(ii) the circumstances known to the signature device holder give rise to a substantial risk that the signature device may have been compromised;

(c) [Where a certificate is used to support the signature device,] [Where the signature device involves the use of a certificate,] exercise reasonable care to ensure the accuracy and completeness of all material representations made by the signature device holder which are relevant to [the life-cycle of the] certificate, or which are to be included in the certificate.

"(2) A signature device holder shall be liable for its failure to satisfy the requirements of paragraph (1)."

Title

97. Concerns were expressed as to the use of the word "responsibilities" in the title of the draft article. It was suggested that that term was too vague since it did not clearly reflect the subject of the draft article, which was the obligations or duties of the signatory. It was recalled that the Working Group had discussed a number of problems raised by the use of the words "duty" and "obligation" at previous meetings, and that "responsibilities" had been widely regarded, at the time, as a less controversial term. It was proposed that, since the purpose of the draft article was to establish a code of conduct for signatories, the title could be "Conduct of signatory". After discussion, that proposal was widely accepted.

Paragraph (1)

98. At the outset, the Working Group discussed the scope of application of paragraph (1). The view was expressed that subparagraphs *(a)* and *(b)* should apply generally to all electronic signatures, while subparagraph *(c)* would only apply to electronic signatures supported by a certificate. In support of that view it was noted that the obligation in paragraph (1) *(a)*, in particular, to exercise reasonable care to prevent unauthorized use of a signature device did not establish an obligation that was unfamiliar and it was, in fact, generally contained in agreements concerning the use of credit cards. A contrary view was that care should be taken in establishing standards of conduct in areas where technology was developing, since those new standards might change existing rules and lead to unintended consequences. It might not be appropriate to apply paragraph (1) *(a)* more widely than to electronic signatures that might, for example, satisfy draft article 6 (3). In response to that view, it was noted that the provision for variation by agreement in draft article 5 would allow the standards set in draft article 9 to be varied in areas where they were thought to be inappropriate, or where they led to unintended consequences. In response to a further concern as to the application of the Uniform Rules to consumers and the effect of the standard of reasonable care, it was recalled that the Uniform Rules were not intended to overrule laws designed for the protection of consumers.

99. After discussion, the Working Group agreed that subparagraphs *(a)* and *(b)* should apply generally to all signatures, and that subparagraph *(c)* should apply only to signatures supported by certificates. It was noted that a broad application of subparagraphs *(a)* and *(b)* would need to be borne in mind when discussing the definition of "signature device holder" or "signatory".

100. With respect to paragraph (1) *(b)*, concern was expressed as to the meaning of the words "appropriate person". It was questioned whether it was obvious with respect to all technologies that there would be an appropriate person who should be notified. One view was that it was clear that "appropriate" referred not only to persons who might seek to rely on the signature, but also to persons such as certification service providers, certificate revocation service providers and others. A further view was that the identity of the appropriate person would be covered by the contractual context of the signature use. To address those concerns, it was proposed that the reference to "appropriate persons" should be replaced by wording along the following lines:

"Without undue delay, notify persons who may reasonably be expected by the signatory to rely on or to provide services in support of the electronic signature".

That proposal was widely supported.

101. With respect to paragraph (1) *(c)*, support was expressed in favour of retaining the words first appearing in square brackets, "Where a certificate is used to support the signature device", without the square brackets, and removing the brackets from the words "the life-cycle of the certificate". It was suggested that the meaning of that phrase should be clearly explained in the guide to enactment. As to the application of paragraph (1) *(c)*, concern was expressed as to the type of certificate covered by that provision. One view was that it might not be appropriate to apply the provision to both low-cost and high-cost certificates, since the duty of care might be excessive in relation to the former. A contrary view was that the standard of "reasonable care" would ensure that the appropriate level of care was applied to all different types of certificates.

Paragraph (2)

102. Concerns were expressed as to the need to retain paragraph (2) in the draft article. One view was that, as currently drafted, paragraph (2) should be deleted as it added nothing to the draft article. It did not specify either the consequences or the limits of liability, both of which were left to national law. A contrary view was that paragraph (2), even though it left the consequences of liability up to national law, did serve to give a clear signal to enacting States that liability should attach to a failure to satisfy the obligations set forth in paragraph (1). It was noted that paragraph 53 of the note by the secretariat (A/CN.9/WG.IV/WP.84) provided a useful explanation of paragraph (2) and should be included in the guide to enactment.

103. One proposal to amend paragraph (2) was intended to express more clearly that there was to be liability for failure to satisfy paragraph (1) and that the limits of liability were to be determined by the enacting State:

"The legal consequences of the signature holder's failure to satisfy the requirements of paragraph (1) shall be determined by the enacting State."

104. A further proposal was to retain the existing text of paragraph (2) and to clarify its intent by adding in square brackets the words [*The limits and conditions of liability are to be determined by the enacting State.*]. Neither of those two proposals were supported.

105. A further proposal was to add a test of foreseeability to paragraph (2), in the same manner as the current text of draft article 10. It was observed that that test was increasingly accepted in international trade and would serve to establish an agreed standard for liability. It was recalled, however, that such a test had been proposed at a previous session of the Working Group, but had not received support. That proposal was not pursued. After discussion, the Working Group agreed to adopt the existing text of paragraph (2).

Article 10. *Responsibilities of a supplier of certification services*

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

"(1) A supplier of certification services shall:

(a) act in accordance with the representations it makes with respect to its practices;

(b) exercise due diligence to ensure the accuracy and completeness of all material representations made by the supplier of certification services that are relevant to the life-cycle of the certificate or which are included in the certificate;

(c) provide reasonably accessible means which enable a relying party to ascertain:

(i) the identity of the supplier of certification services;

(ii) that the person who is identified in the certificate holds, at the relevant time, the signature device referred to in the certificate;

(iii) the method used to identify the signature device holder;

(iv) any limitations on the purposes or value for which the signature device may be used; and

(v) whether the signature device is valid and has not been compromised;

(d) provide a means for signature device holders to give notice that a signature device has been compromised and ensure the operation of a timely revocation service;

(e) utilize trustworthy systems, procedures and human resources in performing its services.

"(2) In determining whether and the extent to which any systems, procedures and human resources are trustworthy for the purposes of subparagraph *(e)* of paragraph (1), regard shall be had to the following factors:

(a) financial and human resources, including existence of assets within the jurisdiction;

(b) trustworthiness of hardware and software systems;

(c) procedures for processing of certificates and applications for certificates and retention of records;

(d) availability of information to the [signers][subjects] identified in certificates and to potential relying parties;

(e) regularity and extent of audit by an independent body;

(f) the existence of a declaration by the State, an accreditation body or the supplier of certification services regarding compliance with or existence of the foregoing;

(g) susceptibility to the jurisdiction of courts of the enacting State; and

(h) the degree of discrepancy between the law applicable to the conduct of the supplier of certification services and the law of the enacting State.

"(3) A certificate shall state:

(a) the identity of the supplier of certification services;

(b) that the person who is identified in the certificate holds, at the relevant time, the signature device referred to in the certificate;

(c) that the signature device was effective at or before the date when the certificate was issued;

(d) any limitations on the purposes or value for which the certificate may be used; and

(e) any limitation on the scope or extent of liability which the supplier of certification services accepts to any person.

"*Variant X*

"(4) A supplier of certification services shall be liable for its failure to satisfy the requirements of paragraph (1).

"(5) Liability of the supplier of certification services may not exceed the loss which the supplier of certification services foresaw or ought to have foreseen at the time of its failure in the light of facts or matters which the supplier of certification services knew or ought to have known to be possible consequences of the supplier of certification services' failure to [fulfil the obligations [duties] in][satisfy the requirements of] paragraph (1).

"*Variant Y*

"(4) A supplier of certification services shall be liable for its failure to satisfy the requirements of paragraph (1).

"(5) In assessing the loss, regard shall be had to the following factors:

(a) the cost of obtaining the certificate;

(b) the nature of the information being certified;

(c) the existence and extent of any limitation on the purpose for which the certificate may be used;

(d) the existence of any statement limiting the scope or extent of the liability of the supplier of certification services; and

(e) any contributory conduct by the relying party.

"*Variant Z*

"(4) If damage has been caused as a result of the certificate being incorrect or defective, a supplier of certification services shall be liable for damage suffered by either:

(a) a party who has contracted with the supplier of certification services for the provision of a certificate; or

(b) any person who reasonably relies on a certificate issued by the supplier of certification services.

"(5) A supplier of certification services shall not be liable under paragraph (2):

(a) if, and to the extent, it included in the certificate a statement limiting the scope or extent of its liability to any relevant person; or

(b) if it proves that it [was not negligent][took all reasonable measures to prevent the damage]."

Paragraph (1)

107. A suggestion of a drafting nature was that paragraphs (1)*(c)* and (3) should be merged, with some criteria being identified as essential for inclusion in the certificate and others to be included in the certificate or otherwise made available or accessible to the relying party, where they would be relevant to a particular certificate. The factors proposed as essential for inclusion in the certificate (to be set forth in paragraph (1)*(c)*) were those in paragraph (1)*(c)*(i) and (ii) and paragraph (3)*(c)*. The remainder of paragraphs (1)*(c)* and (3) was proposed for inclusion in the second category, to be set forth in a new paragraph (1)*(d)*. That proposal was widely supported.

108. Some concern was expressed as to whether paragraph (3)*(e)*, dealing with limitations on the liability of the certification services supplier, should be included in the second category of criteria or in the certificate itself. One view was that such a limitation should be clearly included in the certificate. A contrary view was that, since technology was developing in such a way that the amount of information that could be included in the certificate was very limited, to include the information required in paragraph (3)*(c)* to *(e)* might be out of step with technology and therefore unsustainable. It was observed that the approach of article 5*bis* of the Model Law, which addressed incorporation by reference, might offer a solution to the difficulty of limited space in the certificate. What would be required would be a reference to the existence of the limitation and an indication of where the precise terms could be found. After discussion, it was agreed that paragraph (3)*(e)* should be included in the second category of information in a new paragraph (1)*(d)*.

109. Further suggestions of a drafting nature were: *(a)* to replace the reference to "due diligence" in paragraph (1)*(b)* with "reasonable care"; *(b)* to replace "ensure" in paragraph (1)*(b)* with "validate" or "verify"; *(c)* to add a reference to a certificate to paragraph (1)*(c)*(iv) so that limitations on purpose and value would relate to both signatures and certificates; and *(d)* to clarify the reference to "valid" in paragraph (1)*(c)*(v) by substituting the word "operational". With the exception of the proposal to change the reference to "ensure" in *(b)* above, those proposals received wide support.

110. It was observed that since representations by the supplier of certification services might relate not only to its practices, but also to its policy statements, a reference to policy should be included in paragraph (1)*(a)*. That proposal was widely supported.

111. Some concern was expressed as to the meaning of paragraph (1)*(c)*(ii). It was observed that it would be difficult for the supplier of certification services to make available to a relying party information which showed that the person identified in the certificate was the holder of the signature device at any relevant time. It was suggested that that notion should be replaced by the notion of control in article 6(3) as follows:

"(ii) that the person who is identified in the certificate had control of the signature device at the time of signing;"

112. It was observed that the reference in paragraph (1)*(d)* might not be appropriate for some certificates, such as transactional certificates, which are one-time certificates, or low-cost certificates for low-risk applications, both of which might not be subject to revocation. To satisfy that concern, it was proposed that paragraph (1)*(d)* should be expressed not as a requirement, but as a statement that a timely revocation service existed and that a means of providing notice as to compromise of the signature device existed. Information in respect of both of those elements could be included in a new paragraph (1)*(d)* (as proposed in para. 2 above) as follows:

"*(d)* (v) whether a means exists for the signatory to give notice that a signature device has been compromised;

"*(d)* (vi) whether a timely revocation service is offered;"

113. While that proposal was widely supported, it was observed that, since paragraph (1)*(d)* imposed an obligation on the supplier of certification services in respect of the signatory, that notion might need to be retained in draft article 10(1) in addition to the information proposed for addition to a new paragraph (1)*(d)*, which would be relevant to relying parties. It was agreed that paragraph (1)*(d)* should be retained in addition to the text proposed for subparagraphs *(d)*(v) and *(d)*(vi).

114. After discussion, the Working Group decided that paragraph (1) should read along the following lines, subject to revision by a drafting group to ensure consistency of the various provisions and language versions:

"(1) A supplier of certification services shall:

(a) act in accordance with representations it makes with respect to its policies and practices;

(b) exercise reasonable care to ensure the accuracy and completeness of all material representations made by the supplier of certification services that are relevant to the life-cycle of the certificate or which are included in the certificate;

(c) provide reasonably accessible means which enable a relying party to ascertain in the certificate:

(i) the identity of the supplier of certification services;

(ii) that the person who is identified in the certificate has control of the signature device at the time of signing;

(iii) that the signature device was effective as of or before the date when the certificate was issued;

(d) provide reasonably accessible means to enable a relying party to ascertain in the certificate or otherwise where relevant:

(i) the method used to identify the signatory;

(ii) any limitations on the purposes or value for which the signature device of the certificate may be used;

(iii) whether the signature device is operational and has not been compromised;

(iv) any limitation on the scope or extent of liability which the supplier of certification services accepts to any person;

(v) whether means exist for the signatory to give notice that a signature device has been compromised;

(vi) whether a timely revocation service is offered;

(e) provide a means for a signatory to give notice that a signature device has been compromised and ensure the operation of a timely revocation service;

(f) utilize trustworthy systems, procedures and human resources in performing its services."

Paragraph (2)

115. The view was expressed that paragraph (2) provided guidance which was important for inclusion in the text of the Uniform Rules, but that it should set forth a non-exhaustive list of factors to be taken into account in determining trustworthiness. It was observed that, as there was currently a lack of guidance available on issues such as those addressed in paragraph (2), the inclusion of the paragraph in draft article 10 would provide useful assistance.

116. A contrary view, which received substantial support, was that paragraph (2) should be deleted for a number of reasons: first, that it was inappropriate to include such a technical list in a legislative text; secondly, that it was likely to cause problems of interpretation; and thirdly, that the notion of trustworthiness could vary depending upon what was expected of the certificate and it might not, therefore, be appropriate to formulate a single list of criteria that would apply to all possible situations. It was proposed that the content of paragraph (2) should be included in a guide to enactment as factors indicating the trustworthiness of the certification services supplier.

117. In response to the proposal to delete paragraph (2), it was recalled that the purpose of including the paragraph in the current draft of article 10 was to ensure that any assessment of the trustworthiness of foreign certificates under draft article 13 could be made upon the basis of the same criteria as would apply to domestic certificates under draft article 10, ensuring equality of treatment. In response to that view, it was questioned whether the issue of equivalence in draft article 13 was the same as that of trustworthiness as addressed in draft article 10.

118. It was proposed that if paragraph (2) was to be included in the text of the Uniform Rules, a number of drafting changes would be required. It was proposed that subparagraphs *(g)* and *(h)* were more relevant to draft article 13 and should be deleted from draft article 10. It was also proposed that the reference to "within the jurisdiction" in subparagraph *(a)* was problematic and that what was important was only that the supplier of certification services should have resources to which recourse could be had, not that they must be in the jurisdiction of the enacting State. It was observed that paragraph (2)*(b)* was circular in meaning and that a term such as "quality" or "reliability" should be substituted for "trustworthiness". It was generally agreed that, should the list of factors contained in paragraph (2) be finally retained in the Uniform Rules, those drafting suggestions would need to be taken into account. Under the same proviso, it was agreed that the list of factors would need to be made open-ended, through the inclusion of either the words "inter alia" or an additional subparagraph, which might read "and any other relevant factor". While the relevance of the financial situation of the certification services supplier to trustworthiness was questioned, it was suggested that those factors did help to show that the supplier was reliable and trustworthy and fostered the confidence of users.

119. To address a number of the concerns about including paragraph (2) in draft article 10, it was proposed that a separate article could be formulated which would be relevant to determining trustworthiness under draft article 10 as well as under draft article 13.

120. After discussion, the Working Group decided to retain the contents of paragraph (2) between square brackets and to place the paragraph provisionally in a separate article, pending a final decision to be made after discussion of draft article 13.

Paragraph (4)

121. Wide support was expressed in favour of the basic rule of liability set forth in paragraph (4) of variants X and Y, which left it up to national law to determine the consequences of liability. The view was expressed that paragraph (4) was a sufficient statement of the principle of liability, consistent with what the Working Group had decided in respect of draft article 9 concerning the signatory, and that it was not practicable to consider a second paragraph addressing the consequences of that liability.

122. Concern was expressed that paragraph (4) might be interpreted as a rule of absolute liability and that more might be needed to ensure that the supplier of certification services could prove, for example, the absence of fault or contributory fault. What was required was a provision which ensured that there was no strict liability and no penalties, but compensation for loss. Wording along the following lines was proposed:

> "A supplier of certification services may be liable for loss caused by its failure to satisfy the requirements of paragraph (1)."

123. That proposal did not receive support. It was observed that if liability was to be addressed by a simple statement of principle, that statement should indicate that the supplier of certification services should be liable for certain failures; a discretionary provision was not sufficient. It was suggested that the guide to enactment could confirm that the intention of paragraph (4) was not to establish a rule of strict liability.

Paragraph (5)

124. In support of including a paragraph addressing the consequences of liability as set forth in the three variants of paragraph (5), it was observed that suppliers of certification services performed intermediary functions that were fundamental to electronic commerce and that the question of the liability of such professionals would not be sufficiently addressed by adopting a single provision along the lines of paragraph (4). Although the same provision had been adopted by the Working Group in draft article 9, a distinction was drawn between the classes of persons covered by draft articles 9 and 10. The view was expressed that while paragraph (4) might state an appropriate principle for application to signatories, it was not sufficient for addressing the professional and commercial activities covered by draft article 10. In addition, it was noted that, at the current stage of development of the certification industry, there was insufficient legal analysis of the issues relating to liability of certification service providers and inclusion of a more detailed provision in the draft rules would therefore be very useful. In that connection, it was suggested that further attention might need to be given to establishing a limitation period for exercising legal action based on the liability of the certification services provider.

Variant X

125. Paragraph (5) of variant X received limited support. The view was expressed that the test of foreseeability of damage was widely accepted in international law as an appropriate standard and for that reason could be included in draft article 10. A contrary view was that paragraph (5) of variant X established a standard that was higher than would usually be the case in contract law.

Variant Y

126. Wide support was expressed in favour of including paragraph (5) of variant Y in draft article 10. It was noted that while variants X and Z reflected general rules that were already established, variant Y focused specifically upon electronic commerce and provided a very useful list of factors likely to be of most relevance to that context.

127. As an alternative to including the list of factors in the text, and in order to avoid the difficulties raised with respect to liability in the context of draft article 9, it was proposed that the substance of paragraph (5) of variant Y could be included in the guide to enactment to the Uniform Rules. The view was expressed that the factors should not operate to limit the normal criterion for liability that would exist in many States. It was therefore proposed that paragraph (5) should be stated as indicative criteria or a non-exhaustive list, rather than as a means of interpreting paragraph (4).

Variant Z

128. Limited support was expressed in favour of variant Z. It was observed that variant Z addressed the means by which the supplier of certification services could limit or avoid liability by stating a limit in the certificate or showing that it had not acted negligently. That formulation gave guidance as to how liability should be set, as opposed to the simple statement in paragraph (4), which was little more than a statement of principle and provided no guidance. It was also noted that if the article were limited to paragraph (4), it might be very difficult to prove that the supplier of certification services had not satisfied the requirements in paragraph (1) of draft article 10. In contrast, a provision along the lines of variant Z would enable the burden of proof to be shifted to the supplier of certification services, which in most cases would have the information pertinent to the issue of liability, and should assist the persons named in paragraph (4) of variant Z to prove their case. It was suggested that that type of provision was a good way of striking a balance between what parties must and could prove.

129. A contrary view was that variant Z was too specific as to the parties covered in paragraph (4), that it might not cover situations where the supplier should be liable notwithstanding that it could satisfy the requirements of paragraph (5) and that paragraph (5)*(a)* might create difficulties in States where limitations of liability were not accepted.

130. After discussion, the Working Group adopted paragraph (4) as set forth in variants X and Y, with the substance of paragraph (5) of variant Y to be included in the guide to enactment as a list of indicative criteria.

Article 11. *Reliance on electronic signatures* and Article 12. *Reliance on certificates*

131. It was generally agreed, at the outset of the discussion of draft articles 11 and 12, that the two articles should be considered jointly, in view of the need to merge the two sets of provisions and to address the situation of the relying party in the context of both reliance on a signature and reliance on a certificate.

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

"(1) A person is not entitled to rely on an electronic signature to the extent that it is not reasonable to do so.

"(2) [In determining whether reliance is not reasonable,] [In determining whether it was reasonable for a person to have relied on the electronic signature,] regard shall be had, if appropriate, to:

(a) the nature of the underlying transaction that the electronic signature was intended to support;

(b) whether the relying party has taken appropriate steps to determine the reliability of the electronic signature;

(c) whether the relying party took steps to ascertain whether the electronic signature was supported by a certificate;

(d) whether the relying party knew or ought to have known that the electronic signature device had been compromised or revoked;

(e) any agreement or course of dealing which the relying party has with the subscriber, or any trade usage which may be applicable;

(f) any other relevant factor."

133. The text of draft article 12 as considered by the Working Group was as follows:

"(1) A person is not entitled to rely on the information in a certificate to the extent that it is not reasonable to do so.

"(2) In determining whether reliance is not reasonable,] [In determining whether it was reasonable for a person to have relied on the information in a certificate,] regard shall be had, if appropriate, to:

(a) any restrictions placed upon the certificate;

(b) whether the relying party has taken appropriate steps to determine the reliability of the certificate, including reference to a certificate revocation or suspension list where relevant;

(c) any agreement or course of dealing which the relying party has or had at the relevant time with the supplier of certification services or subscriber or any trade usage which may be applicable;

(d) any other relevant factors.

"*Variant A*

"(3) If reliance on the electronic signature is not reasonable in the circumstances having regard to the factors in paragraph (1), a relying party assumes the risk that the signature is not a valid signature.

"*Variant B*

"(3) If reliance on the signature is not reasonable in the circumstances having regard to the factors in paragraph (1), a relying party shall have no claim against the signature device holder or the supplier of certification services."

Paragraph (1)

134. As to whether a general provision along the lines of paragraph (1) of draft articles 11 and 12 was needed, various views were expressed. One view was that such a provision was unnecessary, since most legal systems would readily come to the conclusion reached in paragraph (1). Another view was that paragraph (1) should be in the form of a positive rule along the following lines: "A person is entitled to rely on an electronic signature or a certificate if and to the extent that it is reasonable to do so." While support was expressed for adopting a positive formulation, an objection was raised on the grounds that the provision might be misread as creating a right for the relying party in the context of any electronically signed document. In that connection, doubts were expressed as to the legal significance of an "entitlement to rely" on a signature or certificate.

135. A proposal was made to rephrase paragraph (1) as follows: "Reliance on an electronic signature or certificate falling within the scope of these Rules shall be protected if, and to the extent that, such reliance is reasonable in the light of all the circumstances." While support was expressed in favour of that proposal, it was generally felt that the notion of reliance on electronic signatures and certificates being "protected" by law might raise difficult questions of interpretation. After discussion, the Working Group agreed that the Uniform Rules would provide sufficient guidance as to the standard of conduct to be observed by the relying party if a provision along the lines of paragraph (2) was retained. It was decided that paragraph (1) should be deleted.

Paragraph (2)

136. Various proposals were made for redrafting paragraph (2). One proposal was that the new provision should read along the following lines:

"The relying party [assumes the risk] [bears the consequences] of not:

(a) taking adequate steps to verify the reliability of an electronic signature;

(b) verifying the existence or revocation of a certificate; and

(c) complying with any restriction contained in the certificate."

137. Wide support was expressed for the substance of the proposal. In response to an objection that such a rule might place a burden on relying parties, particularly where such parties were consumers, it was observed that the Uniform Rules were not intended to overrule any rule governing the protection of consumers. It was pointed out in that connection that the Uniform Rules might play a useful role in educating all parties involved, including relying parties, as to the standard of reasonable conduct to be met with respect to electronic signatures. In addition, it was recalled that establishing a standard of conduct under which the relying party should verify the reliability of the signature through readily accessible means was essential to the development of any public-key infrastructure (PKI) system.

138. A question was raised as to the scope of the notion of "relying party". It was generally agreed that, consistent with industry practice, the notion of "relying party" was intended to cover any party that might rely on an electronic signature. Depending on the circumstances, a "relying party" might thus be any person having or not a contractual relationship with the signatory or the certification services provider. It was even conceivable that the certification services provider or the signatory might themselves become "relying parties". Based on that broad definition of "relying party", concern was expressed that draft article 11 should not result in the subscriber of a certificate being placed under an obligation to verify the validity of the certificate it was purchasing from the certification services provider. It was suggested that further clarification as to this point might need to be inserted in the guide to enactment.

139. Another concern was raised as to the possible impact of establishing as a general obligation that the relying party should verify the validity of the electronic signature or certificate. It was stated that, should it fail to comply with that obligation, the relying party should not be precluded from availing itself of the signature or certificate if reasonable verification would not have revealed that the signature or certificate was invalid. It was generally felt that such a situation should be dealt with by the law applicable outside the Uniform Rules, and mentioned, as appropriate, in the guide to enactment.

140. With a view to improving on the drafting of the proposal contained in paragraph 135 above, the following was proposed as a possible substitute for paragraph (2):

"(1) Where an electronic signature is supported by a certificate, a person intending to rely on that electronic signature bears the risk that it may not be reliable for the purposes of article 6(1) if he has not ascertained from information available to him that the certificate is valid for the purpose of supporting that electronic signature.

"(2) The information referred to in paragraph (1) includes information:

(a) which the certification services provider has made available in accordance with article 10(1)*(c)*; and

(b) any other information known to the person intending to rely, which establishes, or gives rise to a substantial risk, that the certificate is not valid for the purpose of supporting that electronic signature."

141. No support was expressed in favour of the above proposal, which was said to establish an unnecessary and potentially misleading connection between draft article 11 and draft article 6. It was generally felt that the issue of the validity of an electronic signature under draft article 6 should not depend upon the conduct of the relying party. That issue should be kept separate from the issue of whether it was reasonable for a relying party to rely on a signature that did not meet the standard set forth in article 6.

142. Another suggestion building upon the text proposed in paragraph 136 above, and taking into account some of the above-mentioned concerns, was as follows:

"(1) A person is entitled to rely on an electronic signature or a certificate if and to the extent that such reliance is reasonable in the light of all the circumstances.

"(2) A relying party should bear the risk that an electronic signature is not valid if the relying party fails to take reasonable steps to verify the reliability of the electronic signature.

"(3) Where an electronic signature is supported by a certificate, a relying party shall bear the risk that the certificate is not valid if the relying party fails:

(a) to take reasonable steps to verify the existence, suspension or revocation of the certificate; or

(b) to comply with or to observe any restrictions or limitations contained in the certificate.

"(4) If a relying party fails to take the steps set out in paragraphs (2) and (3), such failure may be taken into account in determining:

(a) whether the relying party is entitled to seek recovery from any person; or

(b) the extent to which the amount otherwise recoverable by the relying party should be reduced as a consequence of the relying party's conduct."

143. While some support was expressed for the substance of the proposal, it was generally felt that it would not be appropriate for the Uniform Rules to attempt to deal in any detail with the law of civil or commercial liability, as suggested in paragraph (4) of the new proposal.

144. After discussion, the Working Group decided that draft article 11 should read along the following lines:

"A relying party shall bear the legal consequences of its failure to:

(a) take reasonable steps in the light of the circumstances to verify the reliability of an electronic signature; or

(b) where an electronic signature is supported by a certificate, take reasonable steps in the light of the circumstances to:

(i) verify the validity, suspension or revocation of the certificate; and

(ii) observe any limitation with respect to the certificate."

ANNEX

Draft articles 1 and 3 to 11 of the UNCITRAL Uniform Rules on Electronic Signatures

(as adopted by the UNCITRAL Working Group on Electronic Commerce at its thirty-sixth session, held in New York from 14 to 25 February 2000)

Article 1. *Sphere of application*

These Rules apply where electronic signatures are used in the context* of commercial** activities. They do not override any rule of law intended for the protection of consumers.

*The Commission suggests the following text for States that might wish to extend the applicability of these Rules:

"These Rules apply where electronic signatures are used, except in the following situations: [...]."

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

...

Article 3. *Equal treatment of signature technologies*

None of these Rules, except article 5, shall be applied so as to exclude, restrict or deprive of legal effect any method of creating an electronic signature that satisfies the requirements referred to in article 6 (1) of these Rules or otherwise meets the requirements of applicable law.

Article 4. *Interpretation*

(1) In the interpretation of these Rules, regard is to be had to their international origin and to the need to promote uniformity in their application and the observance of good faith.

(2) Questions concerning matters governed by these Rules which are not expressly settled in them are to be settled in conformity with the general principles on which these Rules are based.

Article 5. *Variation by agreement*

These Rules may be derogated from or their effect may be varied by agreement, unless that agreement would not be valid or effective under the law of the enacting State [or unless otherwise provided for in these Rules].

Article 6. *Compliance with a requirement for a signature*

(1) Where the law requires a signature of a person, that requirement is met in relation to a data message if an electronic signature is used which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

(2) Paragraph (1) applies whether the requirement referred to therein is in the form of an obligation or whether the law simply provides consequences for the absence of a signature.

(3) An electronic signature is considered to be reliable for the purpose of satisfying the requirement referred to in paragraph (1) if:

(a) the means of creating the electronic signature is, within the context in which it is used, linked to the signatory and to no other person;

(b) the means of creating the electronic signature was, at the time of signing, under the control of the signatory and of no other person;

(c) any alteration to the electronic signature, made after the time of signing, is detectable; and

(d) where a purpose of the legal requirement for a signature is to provide assurance as to the integrity of the information to which it relates, any alteration made to that information after the time of signing is detectable.

(4) Paragraph (3) does not limit the ability of any person:

(a) to establish in any other way, for the purpose of satisfying the requirement referred to in paragraph (1), the reliability of an electronic signature; or

(b) to adduce evidence of the non-reliability of an electronic signature.

(5) The provisions of this article do not apply to the following:

[...]

Article 7. *Satisfaction of article 6*

(1) *[Any person, organ or authority, whether public or private, specified by the enacting State as competent]* may determine which electronic signatures satisfy the provisions of article 6.

(2) Any determination made under paragraph (1) shall be consistent with recognized international standards.

(3) Nothing in this article affects the operation of the rules of private international law.

Article 8. *Conduct of the signatory*

(1) Each signatory shall:

(a) exercise reasonable care to avoid unauthorized use of its signature device;

(b) without undue delay, notify any person who may reasonably be expected by the signatory to rely on or to provide services in support of the electronic signature if:

(i) the signatory knows that the signature device has been compromised; or

(ii) the circumstances known to the signatory give rise to a substantial risk that the signature device may have been compromised;

(c) where a certificate is used to support the electronic signature, exercise reasonable care to ensure the accuracy and completeness of all material representations made by the signatory which are relevant to the certificate throughout its life-cycle, or which are to be included in the certificate.

(2) A signatory shall be liable for its failure to satisfy the requirements of paragraph (1).

Article 9. *Conduct of the supplier of certification services*

(1) A supplier of certification services shall:

(a) act in accordance with representations made by it with respect to its policies and practices;

(b) exercise reasonable care to ensure the accuracy and completeness of all material representations made by it that are relevant to the certificate throughout its life-cycle, or which are included in the certificate;

(c) provide reasonably accessible means which enable a relying party to ascertain from the certificate:

(i) the identity of the supplier of certification services;

(ii) that the person who is identified in the certificate had control of the signature device at the time of signing;

(iii) that the signature device was operational on or before the date when the certificate was issued;

(d) provide reasonably accessible means which enable a relying party to ascertain, where relevant, from the certificate or otherwise:

(i) the method used to identify the signatory;

(ii) any limitation on the purpose or value for which the signature device or the certificate may be used;

(iii) that the signature device is operational and has not been compromised;

(iv) any limitation on the scope or extent of liability stipulated by the supplier of certification services;

(v) whether means exist for the signatory to give notice that a signature device has been compromised;

(vi) whether a timely revocation service is offered;

(e) provide a means for a signatory to give notice that a signature device has been compromised, and ensure the availability of a timely revocation service;

(f) utilize trustworthy systems, procedures and human resources in performing its services.

(2) A supplier of certification services shall be liable for its failure to satisfy the requirements of paragraph (1).

[Article 10. *Trustworthiness*

In determining whether and the extent to which any systems, procedures and human resources utilized by a supplier of certification services are trustworthy, regard shall be had to the following factors:

(a) financial and human resources, including existence of assets;

(b) quality of hardware and software systems;

(c) procedures for processing of certificates and applications for certificates and retention of records;

(d) availability of information to signatories identified in certificates and to potential relying parties;

(e) regularity and extent of audit by an independent body;

(f) the existence of a declaration by the State, an accreditation body or the supplier of certification services regarding compliance with or existence of the foregoing; and

(g) any other relevant factor.]

Article 11. *Conduct of the relying party*

A relying party shall bear the legal consequences of its failure to:

(a) take reasonable steps to verify the reliability of an electronic signature; or

(b) where an electronic signature is supported by a certificate, take reasonable steps to:

(i) verify the validity, suspension or revocation of the certificate; and

(ii) observe any limitation with respect to the certificate.

D. Working paper submitted to the Working Group on Electronic Commerce at its thirty-sixth session: draft Uniform Rules on Electronic Signatures: note by the secretariat (A/CN.9/WG.IV/WP.84) [Original: English]

CONTENTS

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 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). 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 no firm decision

[1] *Official Records of the General Assembly, Fifty-first Session, Supplement No. 17* (A/51/17), paras. 223 and 224.

as to the form and content of such work had been reached, the Working Group 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 and 157).

3. The Commission 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 draft Uniform Rules on Electronic Signatures" or "the Uniform Rules"). 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 UNCITRAL Model Law on Electronic Commerce (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.[2]

4. The Working Group began the preparation of the Uniform Rules at its thirty-second session on the basis of a note prepared by the secretariat (A/CN.9/WG.IV/WP.73).

5. At its thirty-first session (1998), the Commission had before it the report of the Working Group on the work of its thirty-second session (A/CN.9/446). 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 that arose 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 realized 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 thirtieth session as to the feasibility of preparing such Uniform Rules and expressed its confidence that more progress could be accomplished by the Working Group at its thirty-third session 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.[3]

6. At its thirty-second session (1999), the Commission had before it the report of the Working Group on the work of its thirty-third (July 1998) and thirty-fourth (February 1999) sessions (A/CN.9/454 and 457). The Commission expressed its appreciation for the efforts accomplished by the Working Group in its preparation of draft Uniform Rules on Electronic Signatures. While it was generally agreed that significant progress had been made at those sessions in the understanding of the legal issues of electronic signatures, it was also felt that the Working Group had been faced with difficulties in the building of a consensus as to the legislative policy on which the Uniform Rules should be based.

7. A view was expressed that the approach currently taken by the Working Group did not sufficiently reflect the business need for flexibility in the use of electronic signatures and other authentication techniques. As currently envisaged by the Working Group, the Uniform Rules placed excessive emphasis on digital signature techniques and, within the sphere of digital signatures, on a specific application involving third-party certification. Accordingly, it was suggested that work on electronic signatures by the Working Group should either be limited to the legal issues of cross-border certification or be postponed altogether until market practices were better established. A related view expressed was that, for the purposes of international trade, most of the legal issues arising from the use of electronic signatures had already been solved in the Model Law. While regulation dealing with certain uses of electronic signatures might be needed outside the scope of commercial law, the Working Group should not become involved in any such regulatory activity.

8. The widely prevailing view was that the Working Group should pursue its task on the basis of its original mandate (see above, para. 3). With respect to the need for uniform rules on electronic signatures, it was explained that, in many countries, guidance from UNCITRAL was expected by governmental and legislative authorities that were in the process of preparing legislation on electronic signature issues, including the establishment of public key infrastructures (PKI) or other projects on closely related matters (see A/CN.9/457, para. 16). As to the decision made by the Working Group to focus on PKI issues and PKI terminology, it was recalled that the interplay of relationships between three distinct types of parties (i.e. key holders, certification authorities and relying parties) corre-

[2]Ibid., *Fifty-second Session, Supplement No. 17* (A/52/17), paras. 249-251.

[3]Ibid., *Fifty-third Session, Supplement No. 17* (A/53/17), para. 208.

sponded to one possible PKI model, but that other models were conceivable, e.g. where no independent certification authority was involved. One of the main benefits to be drawn from focusing on PKI issues was to facilitate the structuring of the Uniform Rules by reference to three functions (or roles) with respect to key pairs, namely, the key issuer (or subscriber) function, the certification function, and the relying function. It was generally agreed that those three functions were common to all PKI models. It was also agreed that those three functions should be dealt with irrespective of whether they were in fact served by three separate entities or whether two of those functions were served by the same person (e.g. where the certification authority was also a relying party). In addition, it was widely felt that focusing on the functions typical of PKI and not on any specific model might make it easier to develop a fully media-neutral rule at a later stage (ibid., para. 68).

9. After discussion, the Commission reaffirmed its earlier decisions as to the feasibility of preparing such uniform rules (see above, paras. 3 and 5) and expressed its confidence that more progress could be accomplished by the Working Group at its forthcoming sessions.[4]

10. The Working Group proceeded with the preparation of the draft Uniform Rules at its thirty-fifth session (Vienna, September 1999) on the basis of a note prepared by the secretariat (A/CN.9/WG.IV/WP.82). The report of that session is contained in document A/CN.9/465.

11. This note contains the revised draft provisions prepared pursuant to the deliberations and decisions of the Working Group, and also pursuant to the deliberations and decisions of the Commission at its thirty-second session, as reproduced above (see above, paras. 6-9). Newly revised provisions are indicated by italic text. For ease of reference, a consolidated text of the draft provisions is attached as annex I to this note.

12. In line with the applicable instructions relating to the stricter control and limitation of United Nations documents, the explanatory remarks to the draft provisions have been kept as brief as possible. Additional explanations will be provided orally at the session.

References to national legislation and other texts

13. For information and comparison, references to national legislation and other texts are included under this heading in boxed text for a number of articles. References to national legislation have been included on the basis of those statutes of which the secretariat is aware and which are available for reference. References to other texts are included on the basis that they were concluded by international organizations or are widely known and publicly available. Abbreviations refer to the following legislation and texts:

Germany:	Digital Signature Law 1997 (Article 3, Information and Communication Services Act, approved 13/6/97; in force 1/8/97);
Illinois:	USA, Electronic Commerce Security Act 1998 (1997 Illinois House Bill 3180; 5 Ill. Comp. Stat. 175, enacted August 1998);
Minnesota:	USA, Electronic Authentication Act (Minnesota Statutes §325, enacted May 1997);
Missouri:	USA, Digital Signature Act, 1998 (1998 SB 680, enacted July 1998);
Singapore:	Electronic Transactions Act 1998, Act No. 25 of 1998;
ABA Guidelines:	American Bar Association, Science and Technology Section, "Digital Signature Guidelines", 1996;
EC Directive:	Directive of the European Parliament and of the Council on a Community framework for electronic signatures, as adopted on 30 November 1999 (PE-CONS 3625/99);
GUIDEC:	International Chamber of Commerce, "General Usage for International Digitally Ensured Commerce", 1997.

I. GENERAL REMARKS

14. 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 legislative 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.

15. 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.

16. 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

[4]Ibid., *Fifty-fourth Session, Supplement No. 17* (A/54/17), paras. 308-314.

by pre-existing contractual rules and procedures to be followed in communicating by electronic means).

17. 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. This draft of the Uniform Rules has been prepared on the basis that they will constitute a separate legal instrument.

18. 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 electronic communication by establishing a security framework and by giving written and electronic messages equal status as regards their legal effect.

19. At the thirty-third session of the Working Group, doubts were expressed as to the appropriateness of using the terms "enhanced" or "secure" to describe signature techniques that were capable of providing a higher degree of reliability than "electronic signatures" in general (A/CN.9/454, para. 29). The Working Group concluded that, in the absence of a more appropriate term, "enhanced" should be retained. At the thirty-fourth session (A/CN.9/457, para. 39), it was suggested that the definition of "enhanced electronic signature" might need to be reconsidered, together with the general architecture of the Uniform Rules, once the purpose of dealing with two categories of electronic signatures had been clarified, particularly as regards the legal effects of both types of electronic signatures. It was suggested that dealing with enhanced electronic signatures offering a high degree of reliability was justified only if the Uniform Rules were to provide a functional equivalent to specific uses of handwritten signatures. Since this was likely to prove particularly difficult at the international level and be of limited relevance to international commercial transactions, the additional benefit to be expected from using an "enhanced electronic signature" as opposed to a mere "electronic signature" might need to be clarified. At the thirty-fifth session of the Working Group, support was expressed in favour of retaining the notion of "enhanced electronic signature", which was described as particularly apt to provide certainty with respect to the use of a certain type of electronic signatures, namely digital signatures implemented through public-key infrastructure (PKI). In response, it was pointed out that the notion of "enhanced electronic signature" made the structure of the Uniform Rules unnecessarily complex. In addition, the notion of "enhanced electronic signature" would lend itself to misinterpretation by suggesting that various layers of technical reliability might correspond to an equally diversified range of legal effects. Widespread concern was expressed that an enhanced electronic signature would be considered as if it were a distinct legal concept, rather than just a description of a collection of technical criteria, the use of which made a method of signing particularly reliable. While postponing its final decision as to whether the Uniform Rules would rely on the notion of "enhanced electronic signature", the Working Group generally agreed that, in preparing a revised draft of the Uniform Rules for continuation of the discussion at a future session, it would be useful to introduce a version of the draft articles that did not rely on that notion (A/CN.9/465, para. 66).

20. In view of that discussion of the need for a category of "enhanced electronic signatures", this revised draft of the Uniform Rules includes an alternative approach for discussion by the Working Group. The definition of "enhanced electronic signature" in draft article 2*(b)* has been maintained in square brackets but is not used in any of the substantive provisions of the Uniform Rules. Where appropriate, the relevant parts of that definition have been inserted in the corresponding provisions. The purpose of this approach is to assist the Working Group in deciding whether the references to both electronic and enhanced electronic signatures should be eliminated so that the Uniform Rules would deal only with a single category of electronic signature. Remarks addressing possible amendment of the definition are included under article 2. Remarks addressing specific proposals are dealt with under respective articles.

21. As agreed by the Working Group at its thirty-fifth session, this revised draft of the Uniform Rules is based on the assumption that the reference to situations "where the law requires a signature" is not limited to cases where an electronic signature is used to meet a mandatory requirement of law that certain documents be signed for validity purposes. Since the law contains very few such requirements with respect to documents used for commercial transactions, the practical result of such misinterpretation would be to reduce unduly the scope of the Uniform Rules. Consistent with the interpretation of the words "the law" adopted by the Commission in paragraph 68 of the Guide to Enactment of the Model Law (under which "the words 'the law' are to be understood as encompassing not only statutory or regulatory law but also judicially-created law and other procedural law"), the Uniform Rules (and the Model Law) are intended to cover very broadly the use of electronic signatures, since most documents used in the context of commercial transactions are likely to be faced, in practice, with the requirements of the law of evidence regarding proof in writing (A/CN.9/465, para. 67).

II. DRAFT ARTICLES ON ELECTRONIC SIGNATURES

Article 1. *Sphere of application*

These Rules apply *where* electronic signatures *are* used in the context* of commercial** *activities. They* do not override any *rule of* law intended for the protection of consumers.

**The Commission suggests the following text for States that might wish to extend the applicability of these Rules:*

"These Rules apply where electronic signatures are used, except in the following situations: [...]."

**The term "commercial" should be given a wide interpretation so as to cover matters arising from all relationships of a commercial nature, whether contractual or not. Relationships of a commercial nature include, but are not limited to, the following transactions: any trade transaction for the supply or exchange of goods or services; distribution agreement; commercial representation or agency;

factoring; leasing; construction of works; consulting; engineering; licensing; investment; financing; banking; insurance; exploitation agreement or concession; joint venture and other forms of industrial or business cooperation; carriage of goods or passengers by air, sea, rail or road.

References to UNCITRAL documents

A/CN.9/465, paras. 36-42;
A/CN.9/WG.IV/WP.82, para. 21;
A/CN.9/457, paras. 53-64.

Remarks

22. The opening words of draft article 1 have been revised to ensure consistency with article 1 of the Model Law (see A/CN.9/465, para. 38). Note * is intended to reflect the same policy as adopted in the context of the Model Law, under which "nothing in the Model Law should prevent an enacting State from extending the scope of the Model Law to cover uses of electronic commerce outside the commercial sphere" (Guide to Enactment of the Model Law, para. 26). The Working Group at its thirty-fifth session decided that such policy should also apply with respect to electronic signatures (ibid., para. 39).

Article 2. *Definitions*

For the purposes of these Rules:

(a) "Electronic signature" means [data in electronic form in, affixed to, or logically associated with, a data message, and] *[any method in relation to a data message]* that may be used to identify the signature holder in relation to the data message and indicate the signature holder's approval of the information contained in the data message;

[*(b) "Enhanced electronic signature" means an electronic signature in respect of which it can be shown, through the use of a [security procedure] [method], that the signature:*

(i) is unique to the signature holder [for the purpose for][within the context in] which it is used;

(ii) was created and affixed to the data message by the signature holder or using a means under the sole control of the signature holder *[and not by any other person];*

[*(iii) was created and is linked to the data message to which it relates in a manner which provides reliable assurance as to the integrity of the message";]*]

(c) "Certificate" means a data message or other record which is issued by an information certifier and which purports to *ascertain* the identity of a person or entity who holds a particular [key pair] *[signature device]*;

(d) "Data message" means information generated, sent, received or stored by electronic, optical or similar means including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy;

(e) "Signature holder" *[device holder] [key holder] [subscriber] [signature device holder] [signer] [signatory]* means a person by whom, or on whose behalf, an enhanced electronic signature can be created and affixed to a data message;

(f) "Information certifier" means a person or entity which, in the course of its business, engages in [providing identification services] [certifying information] which [are][is] used to support the use of [enhanced] electronic signatures.

References to UNCITRAL documents

A/CN.9/465, para. 42;
A/CN.9/WG.IV/WP.82, paras. 22-33;
A/CN.9/457, paras. 22-47; 66-67; 89; 109;
A/CN.9/WG.IV/WP.80, paras. 7-10;
A/CN.9/WG.IV/WP.79, para. 21;
A/CN.9/454, para. 20;
A/CN.9/WG.IV/WP.76, paras. 16-20;
A/CN.9/446, paras. 27-46 (draft article 1), 62-70 (draft article 4), 113-131 (draft article 8), 132 and 133 (draft article 9);
A/CN.9/WG.IV/WP.73, paras. 16-27, 37 and 38, 50-57, and 58-60;
A/CN.9/437, paras. 29-50 and 90-113 (draft articles A, B and C); and
A/CN.9/WG.IV/WP.71, paras. 52-60.

Remarks

23. The Working Group at its thirty-fifth session decided to postpone consideration of the definitions contained in draft article 2 until it had completed its review of the substantive provisions of the Uniform Rules (A/CN.9/465, para. 42).

Definition of "electronic signature"

24. The definition of electronic signature has been drafted in accordance with the decision of the Working Group at its thirty-fourth session (A/CN.9/457, paras. 23-32). The words in square brackets "[any method in relation to a data message]" are included in order to align the language of the definition in the Uniform Rules with that of article 7 of the Model Law.

Definition of "enhanced electronic signature"

25. At its thirty-fifth session, the Working Group discussed whether the notion of "enhanced electronic signature" should be used in the Uniform Rules. Support was expressed in favour of retaining the notion of enhanced electronic signature, which was described as particularly apt to provide certainty with respect to the use of a certain type of electronic signatures, namely digital signatures implemented through public-key infrastructure (PKI). In response, it was pointed out that the notion of "enhanced electronic signature" made the structure of the Uniform Rules unnecessarily complex. In addition, the notion of "enhanced electronic signature" would lend itself to misinterpretation by suggesting that various layers of technical reliability might correspond to an equally diversified range of legal effects. Widespread concern was expressed that an enhanced electronic signature would be considered as if it

were a distinct legal concept, rather than just a description of a collection of technical criteria, the use of which made a method of signing particularly reliable. While postponing its final decision as to whether the Uniform Rules would rely on the notion of "enhanced electronic signature", the Working Group generally agreed that, in preparing a revised draft of the Uniform Rules for continuation of the discussion at a future session, it would be useful to introduce a version of the draft articles that did not rely on that notion (A/CN.9/465, para. 66).

26. In accordance with the decision of the Working Group at its thirty-fourth session (A/CN.9/457, para. 39), the definition of "enhanced electronic signature" includes in subparagraph *(b)*(iii) the language in square brackets as a necessary link between the enhanced signature on the data message and the information contained in the data message, in the form of an integrity function. The Working Group may wish to consider whether integrity should be included as an integral part of the definition of an enhanced electronic signature or whether, as a concept, it is more relevant to the idea of an original, as in article 8 of the Model Law and draft article 7 of these Uniform Rules. The wording previously included as subparagraph (ii), "can be used to identify objectively the signature holder in relation to the data message", has been omitted from the current draft on the basis that it is part of the definition of an "electronic signature" in subparagraph *(a)*.

27. In the opening words of subparagraph *(b)*, the reference to use of a "method", as an alternative to the use of a "security procedure", is intended to align more closely the terminology with that of the Model Law.

28. In subparagraph *(b)*(ii) the words "and not by any other person" have been placed in square brackets as their inclusion raises a number of issues. First, including those words in the definition of enhanced electronic signature may suggest that any signature that is not created and affixed by the signature device holder (and therefore potentially unauthorized) is not an enhanced electronic signature. This interpretation may have the effect of excluding such signatures from the scope of some articles of the Uniform Rules including, for example, draft articles 8, 9 and 11. In particular, the application of those parts of draft article 9 which deal with responsibility for compromise of signature devices could be uncertain.

29. Secondly, the inclusion of those words would require that, in order for a security procedure or method to be an enhanced electronic signature, it must be able to show that the signature was actually created and affixed by the signature device holder. Since for some technologies this may not be possible, including such a requirement may suggest the need for the use of a personal identifier, such as the use of biometrics or some other such technique, in conjunction with the use of the signature device.

30. A further issue which the Working Group may wish to consider in the context of subparagraph *(b)*(ii) is the relationship between the requirement for "sole control" and draft article 9, which provides for obligations of "each" signature device holder. This issue also arises in relation to the definition of "signature holder" below.

31. In subparagraph *(b)*(iii) the phrase "reliable assurance" is intended to maintain consistency with the terminology of article 8 of the Model Law.

Definition of "certificate"

32. A definition of "certificate" may be needed in the Uniform Rules for reasons of completeness. This definition is based upon the definition in A/CN.9/WG.IV/WP.79 of an "identity certificate", although no longer described in these Uniform Rules as an "identity certificate". The Working Group may wish to consider whether the words in square brackets, "or other significant characteristics", can be deleted for the following reason. The concept of identity may be more than a reference to the name of the signature device holder, and may refer to other significant characteristics, such as position or authority, either in combination with a name or without reference to the name. On that basis, it would not be necessary to distinguish between identity and other significant characteristics, nor to limit the Uniform Rules to those situations in which only identity certificates which named the signature device holder were used. For an alternative view of the meaning of "identity" see "Background Paper on Electronic Authentication Technologies and Issues", Joint OECD-Private Sector Workshop on Electronic Authentication, California, 2-4 June 1999, pages 6-9.

33. The Working Group may wish to consider whether the words "confirm the identity" is appropriate, on the basis that the certificate may not actually *confirm* the identity of the signature device holder, but rather identify the signature device holder by following certain procedures and certify that that identity is linked to the signature device or public key listed in the certificate. To ensure that the Uniform Rules are technology-neutral, the Working Group may also wish to consider the use of a technology-neutral formulation such as "signature device" or "signature creation device" as an alternative to the words "key pair", since "key pair" refers specifically to digital signatures. Use of the phrase "key pair" in relation to the definition of "certificate" may be appropriate in situations where certificates are only used in a digital signature context.

Definition of "data message"

34. A definition of "data message" may be needed in the draft Uniform Rules for reasons of completeness. The Working Group may wish to consider the need for inclusion of this definition in the context of the relationship of the Uniform Rules to the Model Law.

Definition of "signature holder"

35. The Working Group did not conclude its discussion on the definition of "signature holder" at its thirty-fourth session (A/CN.9/457, para. 47). The revised definition now includes, in square brackets, a number of terms which the Working Group considered may be more appropriate than "signature holder". This definition may need to be reviewed in the context of subparagraph *(b)*(ii) of the definition of "enhanced electronic signature" above and draft

article 9, as noted at para. 30. In view of a proposal made at the thirty-fifth session of the Working Group, the term "signature holder" has been replaced throughout this note by the term "signature device holder" (see A/CN.9/465, paras. 78-82).

Definition of "information certifier"

36. This definition was not considered by the Working Group at its previous session and remains unchanged. However, in view of earlier discussions (A/CN.9/457, para. 109), the Working Group may wish to consider whether the words "in the course of its business" in the definition of "information certifier" should be interpreted as implying that certification-related activities should be the exclusive business activity of an information certifier or whether, in order to embrace situations such as those where credit card companies would issue certificates, the issuance of certificates as an incidental part of the business of an entity should also be covered. Taking into account a suggestion made at the thirty-fifth session of the Working Group, the term "information certifier" has been replaced throughout the remainder of the Uniform Rules, by the term "supplier of certification services" (A/CN.9/465, para. 125). The Working Group may wish to make a decision as to which terminology should be used.

REFERENCES TO NATIONAL LEGISLATION AND OTHER TEXTS

ABA Guidelines

Part 1. Definitions

1.5. Certificate

A message which at least:

(1) identifies the certification authority issuing it;

(2) names or identifies its subscriber;

(3) contains the subscriber's public key;

(4) identifies the operational period; and

(5) is digitally signed by the certification authority issuing it.

1.6. Certification authority

A person who issues a certificate.

1.27. Relying party

A person who has received a certificate and a digital signature verifiable with reference to a public key listed in the certificate, and is in a position to rely on them.

1.30. Signer

A person who creates a digital signature for a message.

1.31. Subscriber

A person who:

(1) is the subject named or identified in a certificate issued to such person; and

(2) holds a private key that corresponds to a public key listed in that certificate.

EC Directive

Article 2

Definitions

For the purpose of this Directive:

1. "electronic signature" means data in electronic form attached to, or logically associated with, other electronic data and which serves as a method of authentication;

2. "advanced electronic signature" means an electronic signature which meets the following requirements:

(a) it is uniquely linked to the signatory;

(b) it is capable of identifying the signatory;

(c) it is created using means that the signatory can maintain under his sole control; and

(d) it is linked to the data to which it relates in such a manner that any subsequent change of the data is detectable;

3. "signatory" means a person who holds a signature creation device and acts either on their own behalf or on the behalf of the natural or legal person or entity he represents;

4. "signature-creation data" means unique data such as codes or private cryptographic keys, which are used by the signatory in creating an electronic signature;

5. "signature-creation device" means configured software or hardware used to implement the signature-creation data;

6. "secure-signature-creation device" is a signature-creation device that meets the requirements laid down in annex III;

7. "signature-verification data" means data, such as codes or public cryptographic keys, which are used for the purpose of verifying the electronic signature;

8. "signature-verification device" means configured software or hardware used to implement the signature-verification data;

9. "certificate" means an electronic attestation which links a signature-verification data to a person, and confirms the identity of that person;

10. "qualified certificate" means a certificate which meets the requirements laid down in annex I and is provided by a certification-service provider who fulfils the requirements laid down in annex II;

11. "certification-service provider" means an entity or a natural or legal person who issues certificates or provides other services related to electronic signatures; [...].

GUIDEC

VI. Glossary of terms

2. Certificate

A message ensured by a person, which message attests to the accuracy of facts material to the legal efficacy of the act of another person.

4. Certifier

A person who issues a certificate, and thereby attests to the accuracy of a fact material to the legal efficacy of the act of another person.

12. Public key certificate

A certificate identifying a public key to its subscriber, corresponding to a private key held by that subscriber.

14. Subscriber

A person who is the subject of a certificate.

Germany

§2 Definitions

(1) A digital signature within the meaning of this law is a seal on digital data created with a private signature key, which seal allows, by use of the associated public key to which a signature key certificate of a certifier or of the authority under §3 is affixed, the owner of the signature key and the unforged character of the data to be ascertained.

(2) A certifier within the meaning of this law is a natural or legal person which attests to the attribution of public signature keys to natural persons and holds a licence therefor under §4.

(3) A certificate within the meaning of this law is a digital attestation concerning the attribution of a public signature key to a natural person to which a digital signature is affixed (signature key certificate), or a special digital attestation which refers unmistakably to a signature key certificate and contains further information (attribute certificate).

Illinois

Article 5. Electronic records and signature generally

Section 5-105. Definitions

"certificate" means a record that at a minimum: *(a)* identifies the certification authority issuing it; *(b)* names or otherwise identifies its subscriber, or a device or electronic agent under the control of the subscriber; *(c)* contains a public key that corresponds to a private key under the control of the subscriber; *(d)* specifies its operational period; and *(e)* is digitally signed by the certification authority issuing it;

"certification authority" means a person who authorizes and causes the issuance of a certificate;

"electronic signature" means a signature in electronic form attached to or logically associated with an electronic record;

"signature device" means unique information, such as codes, algorithms, letters, numbers, private keys, or personal identification numbers (PINS), or a uniquely configured physical device, that is required, alone or in conjunction with other information or devices, in order to create an electronic signature attributable to a specific person.

Singapore

Part 1. Section 2. Interpretation

"certificate" means a record issued for the purpose of supporting digital signatures which purports to confirm the identity or other significant characteristics of the person who holds a particular key pair;

"certification authority" means a person who or an organization that issues a certificate;

"electronic signature" means any letters, characters, numbers or other symbols in digital form attached to or logically associated with an electronic record, and executed or adopted with the intention of authenticating or approving the electronic record;

"key pair", in an asymmetric cryptosystem, means a private key and its mathematically related public key, having the property that the public key can verify a digital signature that the private key creates;

"private key" means the key of a key pair used to create a digital signature;

"public key" means the key of a key pair used to verify a digital signature;

"subscriber" means a person who is the subject named or identified in a certificate issued to him and who holds a private key that corresponds to a public key listed in that certificate.

Article 3. *[Technology neutrality] [Equal treatment of signatures]*

None of the provisions of these Rules shall be applied so as to exclude, restrict, or deprive of legal effect any method [of *electronic* signature] [that satisfies the requirements *referred to in article 6(1) of these Rules*] [*which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement*] [*or otherwise meets the requirements of applicable law*].

References to UNCITRAL documents

A/CN.9/465, paras. 43-48;
A/CN.9/WG.IV/WP.82, para. 34;
A/CN.9/457, paras. 53-64.

Remarks

37. Draft article 3 is intended to reflect some of the drafting suggestions made in the context of the thirty-fifth session of the Working Group (A/CN.9/465, paras. 47 and 48). In the context of its discussion of draft article 3, the Working Group may wish to decide whether the Uniform Rules should make it clear that any method being used or contemplated for purposes other than creating the functional equivalent of a legally significant handwritten signature (i.e. a method meeting the requirements of draft article 6 or otherwise meeting the requirements of applicable law) does not fall within the scope of the Uniform Rules.

Article 4. *Interpretation*

(1) In the interpretation of these Uniform Rules, regard is to be had to their international origin and to the need to promote uniformity in their application and the observance of good faith.

(2) Questions concerning matters governed by these Uniform Rules which are not expressly settled in them are to be settled in conformity with the general principles on which these Uniform Rules are based.

References to UNCITRAL documents

A/CN.9/465, paras. 49 and 50;
A/CN.9/WG.IV/WP.82, para. 35.

Remarks

38. The substance of draft article 4 has been generally agreed upon by the Working Group at its thirty-fifth session (A/CN.9/465, para. 50).

Article 5. *[Variation by agreement] [Party autonomy] [Freedom of contract]*

These Rules may be derogated from or [their effect may be] varied by agreement, unless otherwise provided in these Rules or in the law of the enacting State.

References to UNCITRAL documents

A/CN.9/465, paras. 51-61;
A/CN.9/WG.IV/WP.82, paras. 36-40;
A/CN.9/457, paras. 53-64.

Remarks

39. The text of draft article 5 reflects a proposal which was widely supported by the Working Group at its thirty-fifth session (A/CN.9/465, para. 59), to the effect of ensuring the freedom of the parties, as among themselves, to derogate from or vary the provisions of these Rules. This autonomy provision relates only to these Rules, and is not intended to affect *ordre public* or mandatory laws applicable to contracts, such as provisions relating to unconscionable contracts.

40. The wording in square brackets has been included as a possible formulation following more closely the wording of article 6 of the United Nations Convention on Contracts for the International Sale of Goods (hereinafter referred to as "the Sales Convention"), as suggested by the Working Group (ibid., para. 61).

Article 6. *[Compliance with requirements for signature] [Presumption of signing]*

(1) Where the law requires a signature of a person, that requirement is met in relation to a data message if *[a method] [an electronic signature]* is used which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

(2) Paragraph (1) applies whether the requirement referred to therein is in the form of an obligation or whether the law simply provides consequences for the absence of a signature.

Variant A

(3) *It is presumed that [a method] [an electronic signature] is reliable for the purpose of satisfying the requirement referred to in paragraph (1) if that method ensures that:*

(a) the data used for the creation of an electronic signature are unique to the holder of the signature [creation] device within the context in which they are used;

(b) the holder of the signature [creation] device [has] [had at the relevant time] sole control of that device;

(c) the electronic signature is linked to the [information] [the data message or the part of that message] to which it relates [in a manner which guarantees the integrity of that information];

(d) the holder of the signature [creation] device is objectively identified within the context [in which the device is used][of the data message].

Variant B

(3) *In the absence of proof to the contrary, the use of an electronic signature is presumed to prove:*

(a) that the electronic signature meets the standard of reliability set out in paragraph (1);

(b) the identity of the alleged signer; and

(c) that the alleged signer approved the information to which the electronic signature relates.

(4) The presumption in paragraph (3) applies only if:

(a) the person who intends to rely on the electronic signature notifies the alleged signer that the electronic signature is being relied upon [as equivalent to the handwritten signature of the alleged signer][as proof of the elements listed in paragraph (3)]; and

(b) the alleged signer fails to notify promptly the person who issues a notification under subparagraph (a) of the reasons for which the electronic signature should not

be relied upon [as equivalent to the hand-written signature of the alleged signer][as proof of the elements listed in paragraph (3)].

Variant C

(3) In the absence of proof to the contrary, the use of an electronic signature is presumed to prove:

(a) that the electronic signature meets the standard of reliability set out in paragraph (1);

(b) the identity of the alleged signer; and

(c) that the alleged signer approved the information to which the electronic signature relates.

[(4)][(5)] The provisions of this article do not apply to the following: [...].

References to UNCITRAL documents

A/CN.9/465, paras. 62-82;
A/CN.9/WG.IV/WP.82, paras. 42-44;
A/CN.9/457, paras. 48-52;
A/CN.9/WG.IV/WP.80, paras. 11 and 12.

Remarks

41. Paragraphs (1) and (2), and the last paragraph of draft article 6 introduce provisions drawn from article 7(1)*(b)*, 7(2), and 7(3) of the Model Law, respectively. Wording inspired by article 7(1)*(a)* of the Model Law is already included in the definition of "electronic signature" under draft article 2*(a)*. However, draft article 2*(a)* describes a method that "may" be used to fulfil the functions of a signature identified in article 7(1)*(a)* of the Model Law. Should the Working Group wish to emphasize that the main goal of paragraph (1) is to deal with the case where any type of electronic signature (including "non-enhanced" methods of authentication) is used for signing purposes (i.e. with intent to create a functional equivalent to a hand-written signature), the Working Group may find it more appropriate to reproduce the entire text of article 7(1) of the Model Law. Paragraph (1) could read as follows:

"(1) Where the law requires a signature of a person, that requirement is met in relation to a data message if:

"*(a)* [a method] [an electronic signature] is used to identify that person and to indicate that person's approval of the information contained in the data message; and

"*(b)* that [method] [electronic signature] is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement".

42. A suggestion was made at the thirty-fifth session of the Working Group that a provision might need to be included in draft article 6 along the following lines: "The legal consequences of the use of a signature shall apply equally to the use of electronic signatures" (see A/CN.9/465, para. 74). The Working Group may wish to discuss the extent to which this notion of equivalence between handwritten and electronic signatures should be further expressed in the body of the Uniform Rules or whether it might be sufficient (and more consistent with the Model Law) to indicate in the guide to enactment (to be prepared at a later stage) that, in interpreting paragraph (1), it should be borne in mind that the purpose of that provision was to ensure that, where any legal consequence would have flowed from the use of a handwritten signature, the same consequence should flow from the use of a reliable electronic signature.

43. As indicated in the report of the thirty-fifth session of the Working Group (A/CN.9/465, para. 64), paragraph (1), to the extent it reproduces article 7(1) of the Model Law, deals with the determination of what constitutes a reliable method of signature in the light of the circumstances. Such a determination can only be made under article 7 of the Model Law by a court or other trier of fact intervening ex post, possibly long after the electronic signature has been used. In contrast, the benefit expected from the Uniform Rules in favour of certain techniques, which are recognized as particularly reliable, irrespective of the circumstances in which they are used, is to create certainty (through either a presumption or a substantive rule), at or before the time any such technique of electronic signature is used (ex ante), that using such a recognized technique will result in legal effects equivalent to those of a handwritten signature. That is the purpose of paragraph (3).

44. Variant A of paragraph (3) is based on language proposed and discussed at the thirty-fifth session of the Working Group (A/CN.9/465, paras. 78-82) for expressing objective criteria of technical reliability of electronic signatures. In subparagraph *(c)*, the necessary linkage between the signature and the information being signed has been expressed so as to avoid the implication that the electronic signature could apply only to the full contents of a data message. In fact, the information being signed, in many instances, will be only a portion of the information contained in the data message.

45. In discussing Variants B and C, the Working Group may wish to clarify, as a matter of policy, whether the Uniform Rules, in establishing criteria of "reliability" of an electronic signature, should deal exclusively with the issues of technical reliability envisaged under Variant A or whether other factors should be taken into account, as an alternative or as an addition to Variant A.

46. Variant B results from a proposal made at the thirty-fifth session of the Working Group (A/CN.9/465, paras. 74 and 75). If adopting Variant B implies the elimination of any linkage between a given level of technical reliability, on the one hand, and the legal consequences that would result from the use of electronic signatures, on the other hand, the effect of paragraphs (3) and (4) would be to create, in favour of any technique that might be used to produce an electronic signature, what has sometimes been referred to as a "low-level presumption", i.e. a presumption that could be easily rebutted by the purported signer through a mere declaration. The Working Group may wish to decide, as a matter of policy, whether the exchange of notices contemplated in Variant B can realistically be imposed on users of electronic signatures, and whether such an exchange of notices would result in the expected level

of user-friendliness and pre-determined certainty as to the legal effects of electronic signatures.

47. Variant C results from a proposal made at the thirty-fifth session of the Working Group (A/CN.9/465, para. 76). Contrary to Variant B, it does not offer a mechanism for easy rebuttal of the presumption it creates. In view of the fact that "proof to the contrary" might require detailed and costly investigations of the various technical devices and procedures involved in the creation of the electronic signature, the effect of Variant C would be to create a very strong presumption as to the legal effectiveness of any technique used to produce an electronic signature.

REFERENCES TO NATIONAL LEGISLATION AND OTHER TEXTS

EC Directive

Article 5

Legal effects of electronic signatures

1. Member States shall ensure that advanced electronic signatures which are based on a qualified certificate and which are created by a secure-signature-creation device:

(a) satisfy the legal requirements of a signature in relation to data in electronic form in the same manner as a handwritten signature satisfies those requirements in relation to paper-based data; and

(b) are admissible as evidence in legal proceedings.

2. Member States shall ensure that an electronic signature is not denied legal effectiveness and admissibility as evidence in legal proceedings solely on the grounds that it is:

— in electronic form; or
— not based upon a qualified certificate; or
— not based upon a qualified certificate issued by an accredited certification-service provider; or
— not created by a secure signature-creation device.

Singapore

Part V. Secure electronic records and signatures

Secure electronic signature

17. If, through the application of a prescribed security procedure or a commercially reasonable security procedure agreed to by the parties involved, it can be verified that an electronic signature was, at the time it was made:

(a) unique to the person using it;

(b) capable of identifying such person;

(c) created in a manner or using a means under the sole control of the person using it; and

(d) linked to the electronic record to which it relates in a manner such that if the record was changed the electronic signature would be invalidated, such signature shall be treated as a secure electronic signature.

Presumptions relating to secure electronic records and signatures

18. [...]

(2) In any proceedings involving a secure electronic signature, it shall be presumed, unless evidence to the contrary is adduced, that:

(a) the secure electronic signature is the signature of the person to whom it correlates; and

(b) the secure electronic signature was affixed by that person with the intention of signing or approving the electronic record.

[Article 7. *Presumption of original*

(1) *A data message is presumed to be in its original form where*, in relation to *that* data message, [a method] *[an electronic signature] [within article 6]* is used which:

(a) provides a reliable assurance as to the integrity of the information from the time when it was first generated in its final form, as a data message or otherwise; and

(b) where it is required that information be presented, that information is capable of being displayed to the person to whom it is to be presented;

(2) The provisions of this article do not apply to the following: [...].]

References to UNCITRAL documents

A/CN.9/465, paras. 83-89;
A/CN.9/WG.IV/WP.82, para. 45;
A/CN.9/457, paras. 48-52;
A/CN.9/WG.IV/WP.80, paras. 13 and 14.

Remarks

48. The text of draft article 7 results from the decision made by the Working Group at its thirty-fifth session (A/CN.9/465, para. 89). The purpose of draft article 7 is to confirm the connection with article 8 of the Model Law and the requirement of integrity. As currently drafted, paragraph (1) does not imply any linkage between the function of preserving the integrity of the information and the signature function under draft article 6. The independence of the two articles, which may apply cumulatively or separately to various authentication techniques, is based on a recognition of the fact that, in a paper-based environment, the corresponding two functions can also be conceived as separate.

Article 8. *Satisfaction of articles 6 and 7*

Variant A

(1) *[The organ or authority specified by the enacting State as competent]* may determine which methods satisfy the requirements of articles 6 and 7.

(2) Any determination made under paragraph (1) *shall* be consistent with recognized international standards.

Variant B

(1) *One or more methods of electronic signature may be determined as satisfying the requirements of articles 6 and 7.*

(2) Any determination made under paragraph (1) *shall* be consistent with recognized international standards.

References to UNCITRAL documents

A/CN.9/465, paras. 90-98;
A/CN.9/WG.IV/WP.82, para. 46;
A/CN.9/457, paras. 48-52;
A/CN.9/WG.IV/WP.80, para. 15.

Remarks

49. The purpose of draft article 8 is to make it clear that an enacting State may designate an organ or authority that will have the power to make determinations on what specific technologies may benefit from the presumptions established in draft articles 6 and 7. As decided by the Working Group at its thirty-fifth session, draft article 8 should not be interpreted in a manner that would prohibit users, for example, from using techniques which had not been determined to satisfy draft articles 6 and 7, if that was what they had agreed to do, as among themselves. Parties should also be free to show, before a court or an arbitral tribunal, that the method of signature they had chosen to use did satisfy the requirements of draft articles 6 and 7, even though not the subject of a prior determination to that effect. Draft article 8 should not be seen as making a recommendation to States as to the only means of achieving recognition of signature technologies, but rather as indicating the limitations that should apply if States wished to adopt such an approach. These points might need to be clearly explained, possibly in a guide to the enactment of the Uniform Rules (see A/CN.9/465, para. 93).

50. The purpose of both Variants A and B is to encourage States to ensure that determinations made under paragraph (1) conform with international standards where applicable, thus facilitating harmonization of practices with respect to enhanced electronic signatures and cross-border use and recognition of signatures. Variant A refers to a possible intervention by the State in the designation of an organ or authority competent to assess the technical reliability of signature techniques (irrespective of whether that organ is established as a public or private entity). Variant B, in order not to over-emphasize the role of the State in making the determinations referred to in paragraph (1), leaves it open whether any organ or authority set up to assess the technical reliability of signature techniques should be established by the State (either as a State organ or as a private entity) or purely industry-based.

51. A proposal made in the context of the thirty-fifth session of the Working Group (namely, that "any determination made should take into account not only whether certain methods satisfied the requirements of draft articles 6 and 7 but also the degree or extent to which those requirements were met"), has not been reflected in the revised version of draft article 8. The Working Group may wish to clarify whether it is envisaged that a requirement such as the use of a handwritten signature (or the production of an original document) could be met only in part with respect to a document processed in an electronic environment, which would seem to depart from the functional-equivalence approach taken throughout the preparation of the Model Law and the Uniform Rules. If the intent of the Working Group is merely to indicate that an electronic signature (or a method ensuring integrity) does not necessarily apply to the entire contents of a data message but should be capable of applying only to a chosen part of the information contained in a given message, that indication may easily be provided in the guide to enactment.

Article 9. *Responsibilities of the signature device holder*

(1) *Each* signature *device* holder shall:

(a) Exercise reasonable care to avoid unauthorized use of its signature device;

(b) Notify appropriate persons without undue delay if:

(i) the signature device holder knows that the signature device has been compromised; or

(ii) the circumstances known to the signature device holder give rise to a substantial risk that the signature device may have been compromised;

(c) [Where a certificate is used to support the signature device,] [Where the signature device involves the use of a certificate,] exercise *reasonable care* to ensure the accuracy and completeness of all material representations made by the signature *device* holder which are relevant to *[the life-cycle of the]* certificate, or which are *to be* included in the certificate.

(2) A signature device holder shall be liable for its failure to satisfy the requirements of paragraph (1).

References to UNCITRAL documents

A/CN.9/465, paras. 99-108;
A/CN.9/WG.IV/WP.82, paras. 50-55;
A/CN.9/457, paras. 65-98;
A/CN.9/WG.IV/WP.80, paras. 18 and 19.

Remarks

52. The substance of draft article 9 has been largely approved by the Working Group at its thirty-fifth session. In paragraph (1), the reference to "each" holder has been introduced to reflect the general view that, in certain cases, it might be unfair to provide that each holder of the device was liable for the entire loss that might have resulted from unauthorized use of the device (e.g. in case of unauthorized use of a corporate signature device held by a number of employees). Accordingly, each holder should only be liable to the extent that it had personally failed to meet the requirements in paragraph (1) (see A/CN.9/465, para. 105).

53. Paragraph (2) is based on the conclusion reached by the Working Group at its thirty-fifth session that it might be difficult to achieve consensus as to what consequences might flow from the liability of the signature device holder. Depending on the context in which the electronic signature was used, such consequences might range, under existing law, from the signature device holder being bound by the contents of the message to liability for damages. Accordingly, paragraph (2) merely establishes the principle that the signature device holder should be held liable for failure to meet the requirements of paragraph (1), and leaves it to the law applicable outside the Uniform Rules in each enacting State to deal with the legal consequences that would flow from such liability (ibid., para. 108). Another view was that a rule based on a test of foreseeability of damage (along the lines of article 74 of the Sales Convention, and restating a basic rule which would apply under readily applicable law in many countries) should have been introduced in draft article 9 (ibid., para. 107).

REFERENCES TO NATIONAL LEGISLATION AND OTHER TEXTS

Paragraph (1)(a)*—material representations*

ABA Guidelines

4.2. Subscriber's obligations

All material representations made by the subscriber to a certification authority, including all information known to the subscriber and represented in the certificate, must be accurate to the best of the subscriber's knowledge and belief, regardless of whether such representations are confirmed by the certification authority.

GUIDEC

VII. Ensuring a message

7. Representations to a certifier

A subscriber must accurately represent to a certifier all facts material to the certificate.

Illinois

Article 20. Duties of subscribers

Section 20-101. Obtaining a certificate

All material representations knowingly made by a person to a certification authority for purposes of obtaining a certificate naming such person as a subscriber must be accurate and complete to the best of such person's knowledge and belief.

Section 20-105. Acceptance of a certificate

[...]

(b) By accepting a certificate, the subscriber listed in the certificate represents to any person who reasonably relies on information contained in the certificate, in good faith and during its operational period, that:

(1) the subscriber rightfully holds the private key corresponding to the public key listed in the certificate;

(2) all representations made by the subscriber to the certification authority and material to the information listed in the certificate are true; and

(3) all information in the certificate that is within the knowledge of the subscriber is true.

Singapore

Part IX. Duties of subscribers

Obtaining certificate

37. All material representations made by the subscriber to a certification authority for purposes of obtaining a certificate, including all information known to the subscriber and represented in the certificate, shall be accurate and complete to the best of the subscriber's knowledge and belief, regardless of whether such representations are confirmed by the certification authority.

Paragraph (1)(b)*—notification*

ABA Guidelines

4.4 Initiating suspension or revocation

A subscriber who has accepted a certificate must request the issuing certification authority to suspend or revoke the certificate if the private key corresponding to the public key listed in the certificate has been compromised.

Illinois

Article 20. Duties of subscribers

Section 20-110. Revocation of a certificate

Except as otherwise provided by another applicable rule of law, if the private key corresponding to the public key listed in a valid certificate is lost, stolen, accessible to an unauthorized person, or otherwise compromised during the operational period of the certificate, a subscriber who has learned of the compromise must promptly request the issuing certification authority to revoke the certificate and publish a notice of revocation in all repositories in which the subscriber previously authorized the certificate to be published, or otherwise provide reasonable notice of the revocation.

Section 10-125. Creation and control of signature devices

Except as otherwise provided by another applicable rule of law, whenever the creation, validity, or reliability of an electronic signature created by a qualified security

procedure under [...] is dependent upon the secrecy or control of a signature device of the signer:

(1) the person generating or creating the signature device must do so in a trustworthy manner;

(2) the signer and all other persons that rightfully have access to such signature device must exercise reasonable care to retain control and maintain the secrecy of the signature device, and to protect it from any unauthorized access, disclosure, or use, during the period when reliance on a signature created by such device is reasonable;

(3) in the event that the signer, or any other person that rightfully has access to such signature device, knows or has reason to know that the secrecy or control of any such signature device has been compromised, such person must make a reasonable effort to promptly notify all persons that such person knows might foreseeably be damaged as a result of such compromise, or where an appropriate publication mechanism is available [...], to publish notice of the compromise and a disavowal of any signatures created thereafter.

Singapore

Initiating suspension or revocation

40. A subscriber who has accepted a certificate shall as soon as possible request the issuing certification authority to suspend or revoke the certificate if the private key corresponding to the public key listed in the certificate has been compromised.

Paragraph (1)(c)*—unauthorized use*

ABA Guidelines

4.3 Safeguarding the private key

During the operational period of a valid certificate, the subscriber shall not compromise the private key corresponding to a public key listed in such certificate, and must also avoid compromise during any period of suspension.

GUIDEC

Ensuring a message

6. Safeguarding an ensuring device

If a person ensures a message by means of a device, the person must exercise, at a minimum, reasonable care to prevent unauthorized use of the device.

Illinois

Section 10-125. Creation and control of signature devices

Except as otherwise provided by another applicable rule of law, whenever the creation, validity, or reliability of an electronic signature created by a qualified security procedure under [...] is dependent upon the secrecy or control of a signature device of the signer:

(1) the person generating or creating the signature device must do so in trustworthy manner;

(2) the signer and all other persons that rightfully have access to such signature device must exercise reasonable care to retain control and maintain the secrecy of the signature device, and to protect it from any unauthorized access, disclosure, or use, during the period when reliance on a signature created by such device is reasonable;

(3) in the event that the signer, or any other person that rightfully have access to such signature device, knows or has reason to know that the secrecy or control of any such signature device has been compromised, such person must make a reasonable effort to promptly notify all persons that such person knows might foreseeably be damaged as a result of such compromise, or where an appropriate publication mechanism is available [...] to publish notice of the compromise and a disavowal of any signature created thereafter.

Paragraph (2)—liability

Minnesota

325K.12 Representations and duties upon accepting certificates

Subd.4. Indemnification by subscriber

By accepting a certificate, a subscriber undertakes to indemnify the issuing certification authority for loss or damage caused by issuance or publication of a certificate in reliance on:

(1) a false and material representation of fact by the subscriber;

(2) the failure by the subscriber to disclose a material fact if the representation or failure to disclose was made either with intent to deceive the certification authority or a person relying on the certificate, or with gross negligence. The indemnity provided in this section may not be disclaimed or contractually limited in scope. However, a contract may provide consistent, additional terms regarding the indemnification.

Singapore

Part IX. Duties of subscribers

Control of private key

39. (1) By accepting a certificate issued by a certification authority, the subscriber identified in the certificate assumes a duty to exercise reasonable care to retain control of the private key corresponding to the public key listed in such certificate and prevent its disclosure to a person not authorized to create the subscriber's digital signature.

(2) Such duty shall continue during the operational period of the certificate and during any period of suspension of the certificate.

Article 10. *Responsibilities of a supplier of certification services*

(1) *A supplier of certification services* shall:

(a) act in accordance with the representations it makes with respect to its practices;

(b) exercise due diligence to ensure the accuracy and completeness of all material representations made by the supplier of certification services that are relevant to the life-cycle of the certificate or which are included in the certificate;

(c) provide reasonably accessible means which enable a relying party to ascertain:

(i) the identity of the *supplier of certification services*;

(ii) that the person who is identified in the certificate holds, at the relevant time, the signature device referred to in the certificate;

(iii) the method used to identify the signature *device* holder;

(iv) any limitations on the purposes or value for which the signature device may be used; and

(v) whether the signature device is valid and has not been compromised;

(d) Provide a means for signature *device* holders to give notice that a *signature device* has been compromised and ensure the operation of a timely revocation service;

(e) Utilize trustworthy systems, procedures and human resources in performing its services.

(2) *In determining whether and the extent to which any systems, procedures and human resources are trustworthy for the purposes of subparagraph (e) of paragraph (1), regard shall be had to the following factors:*

(a) financial and human resources, including existence of assets within the jurisdiction;

(b) trustworthiness of hardware and software systems;

(c) procedures for processing of certificates and applications for certificates and retention of records;

(d) availability of information to the [signers][subjects] identified in certificates and to potential relying parties;

(e) regularity and extent of audit by an independent body;

(f) the existence of a declaration by the State, an accreditation body or the supplier of certification services regarding compliance with or existence of the foregoing;

(g) susceptibility to the jurisdiction of courts of the enacting State; and

(h) the degree of discrepancy between the law applicable to the conduct of the supplier of certification services and the law of the enacting State.

(3) A certificate shall state:

(a) the identity of the supplier of certification services;

(b) that the person who is identified in the certificate holds, at the relevant time, the signature device referred to in the certificate;

(c) that the signature device was effective at or before the date when the certificate was issued;

(d) any limitations on the purposes or value for which the certificate may be used; and

(e) any limitation on the scope or extent of liability which the supplier of certification services accepts to any person.

Variant X

(4) A supplier of certification services shall be liable for its failure to satisfy the requirements of paragraph (1).

(5) Liability of the supplier of certification services may not exceed the loss which the supplier of certification services foresaw or ought to have foreseen at the time of its failure in the light of facts or matters which the supplier of certification services knew or ought to have known to be possible consequences of the supplier of certification services' failure to [fulfil the obligations [duties] in][satisfy the requirements of] paragraph (1).

Variant Y

(4) A supplier of certification services shall be liable for its failure to satisfy the requirements of paragraph (1).

(5) In assessing the loss, regard shall be had to the following factors:

(a) the cost of obtaining the certificate;

(b) the nature of the information being certified;

(c) the existence and extent of any limitation on the purpose for which the certificate may be used;

(d) the existence of any statement limiting the scope or extent of the liability of the supplier of certification services; and

(e) any contributory conduct by the relying party.

Variant Z

(4) If damage has been caused as a result of the certificate being incorrect or defective, a supplier of certification services shall be liable for damage suffered by either:

(a) a party who has contracted with the supplier of certification services for the provision of a certificate; or

(b) any person who reasonably relies on a certificate issued by the supplier of certification services.

(5) A supplier of certification services shall not be liable under paragraph (2):

(a) if, and to the extent, it included in the certificate a statement limiting the scope or extent of its liability to any *relevant* person; or

(b) if it proves that it [was not negligent][took all reasonable measures to prevent the damage].

References to UNCITRAL documents

A/CN.9/465, paras. 123-142 (draft article 12);
A/CN.9/WG.IV/WP.82, paras. 59-68 (draft article 12);
A/CN.9/457, paras. 108-119;
A/CN.9/WG.IV/WP.80, paras. 22-24.

Remarks

54. Draft article 10 (formerly draft article 12) has been revised in accordance with decisions of the Working Group at its thirty-fifth session.

55. The substance of paragraph (1) has been found largely acceptable by the Working Group at its previous session, subject to minor drafting changes. Paragraph (2) results from a proposal made at that session to the effect that the characteristics of a supplier of certification services as described in draft article 13 should be taken into account not only in respect of foreign entities but should equally apply to domestic suppliers of certification services (A/CN.9/465, para. 136).

56. Paragraph (3) results from a proposal, which was also met with considerable interest by the Working Group at its previous session, under which draft article 12 should establish an additional rule setting out the minimum contents of a certificate (ibid., para. 135). While the elements to be contained in a certificate are listed in a separate paragraph, it is doubtful whether paragraph (1)*(c)* and paragraph (3) should be kept as separate provisions. The Working Group may wish to clarify whether those two lists should be merged, presumably in subparagraph (1)*(c)*, which could open with wording along the following lines: "indicate in each certificate ...".

57. Paragraphs (4) and (5) deal with the liability of the supplier of certification services.

58. In Variants X and Y, paragraph (4) establishes a rule that the supplier of certification services is responsible for its failure to observe the obligations or duties in paragraph (1), but leaves it up to national law to determine what the consequences of that failure might be.

59. Paragraph (5) of Variant X establishes a rule of foreseeability of damage based upon article 74 of the Sales Convention, This paragraph operates to limit the quantum of any liability of the supplier of certification services which might arise from paragraphs (1) and (2). In Variant Y, paragraph (5) is based on a suggestion made at the thirty-fifth session of the Working Group (A/CN.9/465, para. 140), according to which the Uniform Rules, without interfering with the operation of domestic law, might provide a list of factors to be taken into consideration when applying domestic law to suppliers of certification services.

60. Variant Z was not discussed during the thirty-fifth session of the Working Group. It originates in a feeling, which was widely expressed at the thirty-fourth session of the Working Group (A/CN.9/457, para. 115), that it would be appropriate to create a uniform rule that went beyond merely referring to the applicable law and established a general rule of liability for negligence, subject to possible contractual exemptions (provided that the limitation would not be grossly unfair) and subject to the supplier of certification services exonerating itself by demonstrating that it had fulfilled the obligations under paragraph (1). Paragraph (4) of Variant Z deals with the question of to whom the supplier of certification services may be liable. Paragraph (5) provides a rule permitting the supplier of certification services to rely on any limitation of liability set out in the certificate or to show that it was not negligent or took reasonable measures to prevent the damage occurring (A/CN.9/WG.IV/WP.82, para. 67).

REFERENCES TO NATIONAL LEGISLATION AND OTHER TEXTS

Paragraphs (1), (2) and (3)—general duties

ABA Guidelines

3. Certification authorities

3.1. Certification authority must use trustworthy systems

A certification authority must utilize trustworthy systems in performing its services**.**

3.2. Disclosure

(1) A certification authority must disclose any material certification practice statement, as well as notice of the revocation or suspension of a certification authority certificate.

(2) A certification authority must use reasonable efforts to notify any persons who are known to be or foreseeably will be affected by the revocation or suspension of its certification authority certificate.

(3) [...]

(4) In the event of an occurrence which materially and adversely affects a certification authority's trustworthy system or its certification authority certificate, the certification authority must use reasonable efforts to notify any persons who are known to be or foreseeably will be affected by that occurrence, or act in accordance with procedures specified in its certification practice statement.

3.7. Certification authority's representations in certificate

By issuing a certificate, a certification authority represents to any person who reasonably relies on a certificate or a digital signature verifiable by the public key listed in the certificate, that the certification authority, in accordance with any applicable certification practice statement of which the relying person has notice, has confirmed that:

(1) the certification authority has complied with all applicable requirements of these Guidelines in issuing a certificate, and if the certification authority has published the certificate or otherwise made it available to such reasonably relying person, that the subscriber listed in the certificate has accepted it;

(2) the subscriber identified in the certificate holds the private key corresponding to the public key is listed in the certificate;

(3) [...]

(4) the subscriber's public key and private key constitute a functioning key pair; and

(5) all information in the certificate is accurate, unless the certification authority has stated in the certificate or incorporated by reference in the certificate that the accuracy of specified information is not confirmed.

Further, the certification authority represents that there are no known, material facts omitted from the certificate which would, if known, adversely affect the reliability of its representations under this Guideline.

3.9. Suspension of certificate at subscriber's request

Unless a contract between the certification authority and the subscriber provides otherwise, a certification authority must suspend a certificate as soon as possible after a request by a person whom the certification authority reasonably believes to be:

(1) the subscriber listed in the certificate;

(2) a person duly authorized to act for that subscriber; or

(3) a person acting on behalf of that subscriber, who is unavailable.

3.10. Revocation of certificate at subscriber's request

The certification authority which issued a certificate must revoke it at the request of the subscriber listed in it, if the certification authority has confirmed:

(1) that the person requesting revocation is the subscriber listed in the certificate to be revoked; or

(2) if the requester is acting as an agent, that the requester has sufficient authority to effect revocation.

3.11. Revocation or suspension without the subscriber's consent

A certification authority must suspend or revoke a certificate, regardless of whether the subscriber listed in the certificate consents, if the certification authority confirms that:

(1) a material fact represented in the certificate is false;

(2) a material prerequisite to issuance of the certificate was not satisfied; or

(3) the certification authority's private key or trustworthy system was compromised in a manner materially affecting the certificate's reliability.

Upon effecting such a suspension, or revocation, the certification authority must promptly notify the subscriber listed in the suspended or revoked certificate.

3.12. Notice of suspension or revocation

Promptly upon suspending or revoking a certificate, a certification authority must publish notice of the suspension or revocation if the certificate was published, and otherwise must disclose the fact of suspension or revocation on inquiry by a relying party.

EC Directive

Annex II. Requirements for certification service providers issuing qualified certificates

Certification service providers must:

(a) demonstrate the reliability necessary for offering certification services;

(b) ensure the operation of a prompt and secure directory and a secure and immediate revocation service;

(c) ensure that the date and time when a certificate is issued or revoked can be determined precisely;

(d) verify, by appropriate means in accordance with national law, the identity and, if applicable, any specific attributes of the person to which a qualified certificate is issued;

(e) employ personnel which possesses the expert knowledge, experience, and qualifications necessary for the services provided, in particular competence at managerial level, expertise in electronic signature technology and familiarity with proper security procedures; they must also apply administrative and management procedures which are adequate and correspond to recognized standards;

(f) use trustworthy systems and products which are protected against modification and ensure the technical and cryptographic security of the processes supported by them;

(g) take measures against forgery of certificates, and, in cases where the certification-service provider generates signature-creation data, guarantee confidentiality during the process of generating such data;

(h) maintain sufficient financial resources to operate in conformity with the requirements laid down in the Directive, in particular to bear the risk of liability for damages, for example, by obtaining appropriate insurance;

(i) record all relevant information concerning a qualified certificate for an appropriate period of time, in particular for the purpose of providing evidence of certification for the purposes of legal proceedings. Such recording may be done electronically;

(j) not store or copy signature-creation data of the person to whom the certification-service provider provided key management services;

(k) before entering into a contractual relationship with a person seeking a certificate to support his electronic signature, inform that person by a durable means of communication of the precise terms and conditions regarding the use of the certificate, including any limitations on its use, the existence of a voluntary accreditation scheme and procedures for complaints and dispute settlement. Such information, which may be transmitted electronically, must be in writing and in readily understandable language. Relevant parts of this information must also be made available on request to third parties relying on the certificate;

(l) use trustworthy systems to store certificates in a verifiable form so that:

— only authorized persons can make entries and changes,
— information can be checked for authenticity,
— certificates are publicly available for retrieval only in those cases for which the certificate-holder's consent has been obtained, and
— any technical changes compromising these security requirements are apparent to the operator.

GUIDEC

VIII. Certification

2. Accuracy of representations in certificate

A certifier must confirm the accuracy of all facts set forth in a valid certificate, unless it is evident from the certificate itself that some of the information has not been verified.

3. Trustworthiness of a certifier

A certifier must:

(a) use only technologically reliable information systems and processes, and trustworthy personnel in issuing a certificate and in suspending or revoking a public key certificate and in safeguarding its private key, if any;

(b) have no conflict of interest which would make the certifier untrustworthy in issuing, suspending, and revoking a certificate;

(c) refrain from contributing to a breach of duty by the subscriber;

(d) refrain from acts or omissions which significantly impair reasonable and foreseeable reliance on a valid certificate;

(e) act in a trustworthy manner towards a subscriber and persons who rely on a valid certificate.

4. Notice of practices and problems

A certifier must make reasonable efforts to notify a foreseeably affected person of:

(a) any material certification practice statement; and

(b) any fact material to either the reliability of a certificate which it has issued or its ability to perform its services.

8. Suspension of public key certificate by request

The certifier which issued a certificate must suspend it promptly upon request by a person identifying himself as the subscriber named in a public key certificate, or as a person in a position likely to know of a compromise of the security of a subscriber's private key, such as an agent, employee, business associate, or member of the immediate family of the subscriber.

9. Revocation of public key certificate by request

The certifier which issued a public key certificate must revoke it promptly after:

(a) receiving a request for revocation by the subscriber named in the certificate or that subscriber's authorized agent, and

(b) confirming that the person requesting revocation is that subscriber, or is an agent of that subscriber with authority to request the revocation.

10. Suspension or revocation of public key certificate without consent

The certifier which issued a public key certificate must revoke it, if:

(a) the certifier confirms that a material fact represented in the certificate is false;

(b) the certifier confirms that the trustworthiness of the certifier's information system was compromised in a manner materially affecting the certificate's reliability.

The certifier may suspend a reasonably questionable certificate for the time necessary to perform an investigation sufficient to confirm grounds for revocation pursuant to this article.

11. Notice of revocation or suspension of a public key certificate

Immediately upon suspension or revocation of a public key certificate by a certifier, the certifier must give appropriate notice of the revocation or suspension.

Germany

§5 Issuance of certificates

(1) The certifier shall reliably identify persons who apply for a certificate. It shall confirm the attribution of a public signature key to an identified person by a signature key certificate and shall maintain access to such, as well as to attribute certificates, at all times and for everyone over publicly accessible telecommunications channels in a verifiable manner and with the agreement of the signature key owner.

(2) Upon request of an applicant, the certifier shall record information concerning the applicant's power of representation for a third party or its professional or other licensing in the signature key certificate or in an attribute certificate, insofar as such licensing or the consent of the third party that the power of representation be recorded is reliably demonstrated.

(3) Upon request of an applicant, the certifier shall record a pseudonym in the certificate in place of the applicant's name.

(4) The certifier shall take measures so that data for certificates cannot be forged or falsified in a way which is not visible. It shall furthermore take steps so that the confidentiality of private signature keys is guaranteed. Private signature keys may not be stored by a certifier.

(5) It shall use reliable personnel for the exercise of certification activities, and shall use technical components in accordance with §14 for making signature keys accessible and creating certificates. This also applies to technical components which make possible the verification of certificates under paragraph 1, sentence 2.

§6 Duty of instruction

The certifier shall instruct the applicant under §5 paragraph 1 concerning the measures necessary to contribute to secure digital signatures and their reliable verification. It shall instruct the applicant concerning which technical components fulfil the requirements of §14, paragraphs 1 and 2, as well as concerning the attribution of digital signatures created with a private signature key. It shall point out to the applicant that data with digital signatures may need to be re-signed before the security value of an available signature decreases with time.

§8 Blocking of certificates

(1) A certifier shall block a certificate if a signature key owner or his representative so request, if the certificate was issued based on false information under §7, if the certifier has ended its activities and they are not continued by another certifier, or if the authority orders blocking under §13, paragraph 5, sentence 2. The blocking shall indicate the time from which it applies. Retroactive blocking is not permitted.

Illinois

Article 15. Effect of a digital signature

Section 15-301. Trustworthy services

Except as conspicuously set forth in its certification practice statement, a certification authority and a person maintaining a repository must maintain its operation and perform its services in a trustworthy manner.

Section 15-305. Disclosure

(a) For each certificate issued by a certification authority with the intention that it will be relied upon by third parties to verify digital signature created by subscribers, a certification authority must publish or otherwise make available to the subscriber and all such relying parties:

(1) its certification practice statement, if any, applicable thereto; and

(2) its certificate that identifies the certification authority as a subscriber and that contains the public key corresponding to the private key used by the certification authority to digitally sign the certificate (its "certification authority certificate").

(b) In the event of an occurrence that materially and adversely affects a certification authority's operations or system, its certification authority certificate, or any other aspect of its ability to operate in a trustworthy manner, the certification authority must act in accordance with procedures governing such an occurrence specified in its certification practice statement, or in the absence of such procedures, must use reasonable efforts to notify any persons that the certification authority knows might foreseeably be damaged as a result of such occurrence.

Section 15-310. Issuance of a certificate

A certification authority may issue a certificate to a prospective subscriber for the purpose of allowing third parties to verify digital signatures created by the subscriber only after:

(1) the certification authority has received a request for issuance from the prospective subscriber, and

(2) the certification authority has:

(a) complied with all of the relevant practices and procedures set forth in its applicable certification practice statement, if any; or

(b) in the absence of a certification practice statement addressing these issues, confirmed in a trustworthy manner that:

(i) the prospective subscriber is the person to be listed in the certificate to be issued;

(ii) the information in the certificate to be issued is accurate; and

(iii) the prospective subscriber rightfully holds a private key capable of creating a digital signature, and the public key to be listed in the certificate can be used to verify a digital signature affixed by such private key.

Section 15-315. Representations upon issuance of certificate

(a) By issuing a certificate with the intention that it will be relied upon by third parties to verify digital signatures created by the subscriber, a certification authority represents to the subscriber, and to any person who reasonably relies on information contained in the certificate, in good faith and during its operational period, that:

(1) the certification authority has processed, approved, and issued, and will manage and revoke if necessary, the certificate in accordance with its applicable certification practice statement stated or incorporated by reference in the certificate or of which such person has notice, or in lieu thereof, in accordance with this Act or the law of the jurisdiction governing issuance of the certificate;

(2) the certification authority has verified the identity of the subscriber to the extent stated in the certificate or its applicable certification practice statement, or in lieu thereof, that the certification authority has verified the identity of the subscriber in a trustworthy manner;

(3) the certification authority has verified that the person requesting the certificate holds the private key corresponding to the public key listed in the certificate; and

(4) except as conspicuously set forth in the certificate or its applicable certification practice statement, to the certification authority's knowledge as of the date the certificate was issued, all other information in the certificate is accurate, and not materially misleading.

(b) 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.

Section 15-320. Revocation of a certificate

(a) 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 its applicable certification practice statement, or in the absence of such policies and procedures, as soon as possible after:

(1) receiving a request for revocation by the subscriber named in the certificate, and confirming that the person requesting revocation is the subscriber, or is an agent of the subscriber with authority to request the revocation;

(2) receiving a certified copy of an individual subscriber's death certificate, or upon confirming by other reliable evidence that the subscriber is dead;

(3) being presented with documents effecting a dissolution of a corporate subscriber, or confirmation by other evidence that the subscriber has been dissolved or has ceased to exist;

(4) being served with an order requiring revocation that was issued by a court of competent jurisdiction; or

(5) confirmation by the certification authority that:

(a) a material fact represented in the certificate is false;

(b) a material prerequisite to issuance of the certificate was not satisfied;

(c) the certification authority's private key or system operations were compromised in a manner materially affecting the certificate's reliability; or

(d) the subscriber's private key was compromised.

(b) Upon effecting such a revocation, the certification authority must notify the subscriber and relying parties in accordance with the policies and procedures governing notice of revocation specified in its applicable certification practice statement, or in the absence of such policies and procedures, promptly notify the subscriber, promptly publish notice of the revocation in all repositories where the certification authority previously caused publication of the certificate, and otherwise disclose the fact of revocation on inquiry by a relying party.

Singapore

Part VIII

Duties of certification authorities

Trustworthy system

27. A certification authority must utilize trustworthy systems in performing its services.

Disclosure

28. (1) A certification authority shall disclose:

(a) its certificate that contains the public key corresponding to the private key used by that certification authority to digitally sign another certificate (referred to in this section as a certification authority certificate);

(b) any relevant certification practice statement;

(c) notice of the revocation or suspension of its certification authority certificate; and

(d) any other fact that materially and adversely affects either the reliability of a certificate that the authority has issued or the authority's ability to perform its services.

(2) In the event of an occurrence that materially and adversely affects a certification authority's trustworthy system or its certification authority certificate, the certification authority shall:

(a) use reasonable efforts to notify any person who is known to be or foreseeably will be affected by that occurrence; or

(b) act in accordance with procedures governing such an occurrence specified in its certification practice statement.

Issuing of certificate

29. (1) A certification authority may issue a certificate to a prospective subscriber only after the certification authority:

(a) has received a request for issuance from the prospective subscriber; and

(b) has:

(i) if it has a certification practice statement, complied with all of the practices and procedures set forth in such certification practice statement including procedures regarding identification of the prospective subscriber; or

(ii) in the absence of a certification practice statement, complied with the conditions in subsection (2).

(2) In the absence of a certification practice statement, the certification authority shall confirm by itself or through an authorized agent that:

(a) the prospective subscriber is the person to be listed in the certificate to be issued;

(b) if the prospective subscriber is acting through one or more agents, the subscriber authorized the agent to have custody of the subscriber's private key and to request issuance of a certificate listing the corresponding public key;

(c) the information in the certificate to be issued is accurate;

(d) the prospective subscriber rightfully holds the private key corresponding to the public key to be listed in the certificate;

(e) the prospective subscriber holds a private key capable of creating a digital signature; and

(f) the public key to be listed in the certificate can be used to verify a digital signature affixed by the private key held by the prospective subscriber.

Representations upon issuance of certificate

30. (1) By issuing a certificate, a certification authority represents to any person who reasonably relies on the certificate or 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.

(2) In the absence of such a certification practice statement, the certification authority represents that it has confirmed that:

(a) the certification authority has complied with all applicable requirements of this Act in issuing the certificate, and if the certification authority has published the certificate or otherwise made it available to such relying person, that the subscriber listed in the certificate has accepted it;

(b) the subscriber identified in the certificate holds the private key corresponding to the public key listed in the certificate;

(c) the subscriber's public key and private key constitute a functioning key pair;

(d) all information in the certificate is accurate, 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) the certification authority has no knowledge of any material fact which if it had been included in the certificate would adversely affect the reliability of the representations in paragraphs *(a)* to *(d)*.

(3) Where there is an applicable certification practice statement which has been incorporated by reference in the certificate, or of which the relying person has notice, subsection (2) shall apply to the extent that the representations are not inconsistent with the certification practice statement.

Suspension of certificate

31. Unless the certification authority and the subscriber agree otherwise, the certification authority that issued a certificate shall suspend the certificate as soon as possible after receiving a request by a person whom the certification authority reasonably believes to be:

(a) the subscriber listed in the certificate;

(b) a person duly authorized to act for that subscriber; or

(c) a person acting on behalf of that subscriber, who is unavailable.

Revocation of certificate

32. A certification authority shall revoke a certificate that it issued:

(a) after receiving a request for revocation by the subscriber named in the certificate; and confirming that the person requesting the revocation is the subscriber, or is an agent of the subscriber with authority to request the revocation;

(b) after receiving a certified copy of the subscriber's death certificate, or upon confirming by other evidence that the subscriber is dead; or

(c) upon presentation of documents effecting a dissolution of the subscriber, or upon confirming by other evidence that the subscriber has been dissolved or has ceased to exist.

Revocation without subscriber's consent

33. (1) A certification authority shall revoke a certificate, regardless of whether the subscriber listed in the certificate consents, if the certification authority confirms that:

(a) a material fact represented in the certificate is false;

(b) a requirement for issuance of the certificate was not satisfied;

(c) the certification authority's private key or trustworthy system was compromised in a manner materially affecting the certificate's reliability;

(d) an individual subscriber is dead; or

(e) a subscriber has been dissolved, wound-up or otherwise ceased to exist.

(2) Upon effecting such a revocation, other than under subsection (1)*(d)* or *(e)*, the certification authority shall immediately notify the subscriber listed in the revoked certificate.

Notice of suspension

34. (1) Immediately upon suspension of a certificate by a certification authority, the certification authority shall publish a signed notice of the suspension in the repository specified in the certificate for publication of notice of suspension.

(2) Where one or more repositories are specified, the certification authority shall publish signed notices of the suspension in all such repositories.

Notice of revocation

35. (1) Immediately upon revocation of a certificate by a certification authority, the certification authority shall publish a signed notice of the revocation in the repository specified in the certificate for publication of notice of revocation.

(2) Where one or more repositories are specified, the certification authority shall publish signed notices of the revocation in all such repositories.

Paragraphs (4) and (5)—liability

ABA Guidelines

3.14. Liability of complying certification authority

A certification authority that complies with these Guidelines and any applicable law or contract is not liable for any loss which:

(1) is incurred by the subscriber of a certificate issued by that certification authority, or any other person; or

(2) is caused by reliance upon a certificate issued by the certification authority, upon a digital signature verifiable with reference to a public key listed in a certificate, or upon information represented in such a certificate or repository.

EC Directive

Article 6. Liability

1. As a minimum, member States shall ensure that by issuing a certificate as a qualified certificate to the public or by guaranteeing such a certificate to the public a certification-service provider is liable for damage caused to any entity or legal or natural person who reasonably relies on that certificate:

(a) as regards the accuracy at the time of issuance of all information contained in the qualified certificate and as regards the fact that the certificate contains all the details prescribed for a qualified certificate;

(b) for assurance that at the time of the issuance of the certificate, the signatory identified in the qualified certificate held the signature-creation data corresponding to the signature-creation data given or identified in the certificate;

(c) for assurance that the signature-creation data and the signature-verification data can be used in a complementary manner in cases where the certification-service provider generates them both;

unless the certification-service provider proves that he has not acted negligently.

2. As a minimum member States shall ensure that a certification-service provider who has issued a certificate as a qualified certificate to the public is liable for damage caused to any entity or legal or natural person who reasonably relies on the certificate for failure to register revocation of the certificate unless the certification-service provider proves that he has not acted negligently.

3. Member States shall ensure that a certification-service provider may indicate in a qualified certificate limitations on the use of that certificate, provided that the limitations are recognizable to third parties. The certification-service provider shall not be liable for damages arising from use of a qualified certificate which exceeds the limitations placed on it.

4. Member States shall ensure that a certification-service provider may indicate in the qualified certificate a limit on the value of transactions for which the certificate can be used, provided that the limit is recognizable to third parties. The certification-service provider shall not be liable for damages arising from this maximum limit being exceeded.

5. The provisions of paragraphs 1 to 4 shall be without prejudice to Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts.

Missouri

Section 17.1

By specifying a recommended reliance limit in a certificate, the issuing certification authority and the accepting subscriber recommend that persons rely on the certificate only to the extent that the total amount at risk does not exceed the recommended reliance limit.

Section 17.2

Unless a licensed certification authority waives application of this subsection, a licensed certification authority is:

(1) not liable for any loss caused by reliance on a false or forged digital signature of a subscriber, if, with respect to the false or forged digital signature, the certification authority complied with all material requirements of sections 1 to 27 of this Act;

(2) not liable in excess of the amount specified in the certificate as its recommended reliance limit for either:

(a) a loss caused by reliance on a misrepresentation in the certificate of any fact that the licensed certification authority is required to confirm; or

(b) failure to comply with section 10 of this Act in issuing the certificate;

(3) Liable only for direct, compensatory damages in any action to recover a loss due to reliance on the certificate, which damages do not include:

(a) punitive or exemplary damages;

(b) damages for lost profit, savings or opportunity; or

(c) damages for pain or suffering.

Singapore

Liability limits for licensed certification authorities

45. Unless a licensed certification authority waives the application of this section, a licensed certification authority:

(a) shall not be liable for any loss caused by reliance on a false or forged digital signature of a subscriber, if, with respect to the false or forged digital signature, the licensed certification authority complied with the requirements of this Act;

(b) shall not be liable in excess of the amount specified in the certificate as its recommended reliance limit for either:

(i) a loss caused by reliance on a misrepresentation in the certificate of any fact that the licensed certification authority is required to confirm; or

(ii) failure to comply with sections 29 and 30 in issuing the certificate.

Article 11. *Reliance on electronic signatures*

(1) A person is not entitled to rely on *an electronic signature* to the extent that it is not reasonable to do so.

(2) [In determining whether reliance is not reasonable,] *[In determining whether it was reasonable for a person to have relied on the electronic signature*,] regard shall be had, if appropriate, to:

(a) the nature of the underlying transaction that the electronic signature was intended to support;

(b) whether the relying party has taken appropriate steps to determine the reliability of the electronic signature;

(c) whether the relying party took steps to ascertain whether the electronic signature was supported by a certificate;

(d) whether the relying party knew or ought to have known that the electronic signature *device* had been compromised or revoked;

(e) any agreement or course of dealing which the relying party has with the subscriber, or any trade usage which may be applicable;

(f) any other relevant factor.

Article 12. *Reliance on certificates*

(1) A person is not entitled to rely on *the information in* a certificate to the extent that it is not reasonable to do so.

(2) In determining whether reliance is not reasonable,] *[In determining whether it was reasonable for a person to have relied on the information in a certificate,]* regard shall be had, if appropriate, to:

(a) any restrictions placed upon the certificate;

(b) whether the relying party has taken appropriate steps to determine the reliability of the certificate, including reference to a certificate revocation *or suspension* list where relevant;

(c) any agreement or course of dealing which the relying party has *or had at the relevant time* with the supplier of certification services or subscriber or any trade usage which may be applicable;

(d) any other relevant factors.

Variant A

(3) If reliance on the electronic signature is not reasonable in the circumstances having regard to the factors in paragraph (1), a relying party assumes the risk that the signature is not a valid signature.

Variant B

(3) If reliance on the signature is not reasonable in the circumstances having regard to the factors in paragraph (1), a relying party shall have no claim against the signature device holder or the supplier of certification services.

References to UNCITRAL documents

A/CN.9/465, paras. 109-122 (draft articles 10 and 11);
A/CN.9/WG.IV/WP.82, paras 56-58 (draft articles 10 and 11);
A/CN.9/457, paras. 99-107;
A/CN.9/WG.IV/WP.80, paras. 20 and 21.

Remarks

61. Draft articles 11 and 12, which deal respectively with the reasonableness of reliance on electronic signatures and certificates, have been subject to minor redrafting as a result of the deliberations by the Working Group at its thirty-fifth session. While the prevailing view of the Working Group at its thirty-fourth session was that provisions should be included in the Uniform Rules regarding the obligations of the party who intended to rely on a certificate, doubts were expressed at the thirty-fifth session with respect to the usefulness of the notion of "reliance", which relates both to the message and the signature, and which might raise difficult questions when confronted with the law of obligations and the need to assign risk (see A/CN.9/465, para. 111). The Working Group may wish to decide, as a matter of policy, whether the Uniform Rules should expressly establish obligations binding on the relying parties. If articles 11 and 12 are understood as setting out obligations for the relying parties, the consequences of failure to fulfil those obligations may need to be further examined. If articles 11 and 12 are understood as establishing a mere "code of conduct", without addressing the consequences of failure to follow the conduct indicated (see A/CN.9/465, para. 113), such suggestions for conduct by a relying party might more appropriately be included in explanatory material such as a guide to enactment of the Uniform Rules.

62. Variants A and B, which are both based on the assumption that the Uniform Rules should deal with the legal consequences that might flow from the failure by a relying party to exercise due care in assessing the reliability of an electronic signature (whether such an electronic signature is

supported or not by a certificate), are intended to reflect the two proposals made in that respect at the thirty-fifth session of the Working Group (A/CN.9/465, para. 117).

63. The Working Group may wish to further consider the relationship between draft articles 11 and 12, on the one hand, and draft article 6, on the other hand.

REFERENCES TO NATIONAL LEGISLATION AND OTHER TEXTS

ABA Guidelines

5.3. Unreliable digital signatures

(1) [...]

(2) Unless otherwise provided by law or contract, a relying party assumes the risk that a digital signature is invalid as a signature or authentication of the signed message, if reliance on the digital signature is not reasonable under the circumstances in accordance with the factors listed in Guideline 5.4 (reasonableness of reliance).

5.4. Reasonableness of reliance

The following factors, among others, are significant in evaluating the reasonableness of a recipient's reliance upon a certificate, and upon digital signatures verifiable with reference to the public key listed in the certificate:

(1) facts which the relying party knows or of which the relying party has notice, including all facts listed in the certificate or incorporated in it by reference;

(2) the value or importance of the digitally signed message, if known;

(3) the course of dealing between the relying person and subscriber and the available indicia of reliability or unreliability apart from the digital signature;

(4) usage of trade, particularly trade conducted by trustworthy systems or other computer-based means.

2.3. Reliance on certificates foreseeable.

It is foreseeable that persons relying on a digital signature will also rely on a valid certificate containing the public key by which the digital signature can be verified.

GUIDEC

VIII. Certification

1. Effect of a valid certificate

A person may rely on a valid certificate as accurately representing the fact or facts set forth in it, if the person has no notice that the certifier has failed to satisfy a material requirement of ensured message practice.

Singapore

Part VI. Effect of digital signatures

Unreliable digital signatures

22. Unless otherwise provided by law or contract, a person relying on a digitally signed electronic record assumes the risk that the digital signature is invalid as a signature or authentication of the signed electronic record, if reliance on the digital signature is not reasonable under the circumstances having regard to the following factors:

(a) facts which the person relying on the digitally signed electronic record knows or has notice of, including all facts listed in the certificate or incorporated in it by reference;

(b) the value or importance of the digitally signed electronic record, if known;

(c) the course of dealing between the person relying on the digitally signed electronic record and the subscriber and the available indicia of reliability or unreliability apart from the digital signature; and

(d) any usage of trade, particularly trade conducted by trustworthy systems or other electronic means.

Article 13. *Recognition of foreign certificates and electronic signatures*

[(1) In determining whether, or the extent to which, a certificate [*or an electronic signature*] is legally effective, no regard shall be had to the place where the certificate [*or the electronic* signature] was issued, nor to the State in which the issuer had its place of business.]

(2) Certificates issued by a foreign *supplier of certification services* are recognized as legally equivalent to certificates issued by *suppliers of certification services* operating under ... *[the law of the enacting State]* if the practices of the foreign *suppliers of certification services* provide a level of reliability at least equivalent to that required of *suppliers of certification services* under ... *[the law of the enacting State]*. [Such recognition may be made through a published determination of the State or through bilateral or multilateral agreement between or among the States concerned.]

(3) Signatures complying with the laws of another State relating to electronic signatures are recognized as legally equivalent to signatures under ... *[the law of the enacting State]* if the laws of the other State require a level of reliability at least equivalent to that required for such 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.]

(4) In determining equivalence, regard shall be had, *if appropriate, [to the factors in paragraph (2) of article 10]* [to the following factors:

(a) financial and human resources, including existence of assets within the jurisdiction;

(b) trustworthiness of hardware and software systems;

(c) procedures for processing of certificates and applications for certificates and retention of records;

(d) availability of information to the [signers][subjects] identified in certificates and to potential relying parties;

(e) regularity and extent of audit by an independent body;

(f) the existence of a declaration by the State, an accreditation body or the certification authority regarding compliance with or existence of the foregoing;

(g) susceptibility to the jurisdiction of courts of the enacting State; and

(h) the degree of discrepancy between the law applicable to the conduct of the certification authority and the law of the enacting State].

(5) Notwithstanding paragraphs (2) and (3), parties to commercial and other transactions may specify that a particular *supplier of certification services*, class of *suppliers of certification services* or class of certificates must be used in connection with messages or signatures submitted to them.

(6) *Where, notwithstanding paragraphs (2) and (3), parties agree, as between themselves, to the use of certain types of electronic signatures and certificates,[that agreement shall be recognized as sufficient for the purpose of cross-border recognition]. [In determining whether, or the extent to which, an electronic signature or certificate is legally effective, regard shall be had to any agreement between the parties to the transaction in which that signature or certificate is used.]*

References to UNCITRAL documents

A/CN.9/465, paras. 21-35;
A/CN.9/WG.IV/WP.82, paras. 69-71;
A/CN.9/454, para. 173;
A/CN.9/446, paras. 196-207 (draft article 19);
A/CN.9/WG.IV/WP.73, para. 75;
A/CN.9/437, paras. 74-89 (draft article I); and
A/CN.9/WG.IV/WP.71, paras. 73-75.

Remarks

64. While there was general support at the thirty-fifth session of the Working Group for the principle of non-discrimination set forth in paragraph (1), doubts were expressed as to whether it was appropriate to refer to the country of origin. The view was expressed that reference to the country of origin resulted in a non-discrimination provision that was too narrow, and left open the possibility that discrimination could occur on a number of other grounds, which would be undesirable. The view was also expressed that, in fact, there might be cases where the country of origin of the signature or certificate was essential to the question of recognition. However, no support was expressed in favour of a proposal to replace the current wording under which "no regard" should be had to the country of origin, by wording to the effect that determination of the legal effect of an electronic signature should not be based "solely" on the country of origin (see A/CN.9/465, paras. 23-24). The Working Group may wish to decide, as a matter of policy, whether a precise statement embodying the principle of non-discrimination should be included in draft article 13 or whether the expression of that principle should be left for a more general reference in a preamble or in a guide to enactment of the Uniform Rules.

65. Paragraphs (2), (3), (4) and (5) were largely agreed upon by the Working Group at its previous session as setting out an appropriate rule on recognition of foreign certificates and signatures (ibid., para. 34). As regards the factors listed in paragraph (4), a cross-reference to draft article 10 might be sufficient if the same factors are used for determining the trustworthiness of systems used by domestic suppliers of certification services. Paragraph (5) reflects a general view in the Working Group that parties to commercial and other transactions should be accorded the right to choose the particular supplier of certification services, class of suppliers of certification services or class of certificates that they wish to use in connection with messages or signatures that they receive. The reference to parties to commercial and other transactions is intended to include government agencies acting in their commercial capacity.

66. Paragraph (6) contains suggestions for expressing the decision made by the Working Group at its thirty-fifth session that draft article 13 should provide for the recognition of agreements between interested parties regarding the use of certain types of electronic signatures or certificates as sufficient grounds for cross-border recognition (as between those parties) of such agreed signatures or certificates (A/CN.9/465, para. 34).

67. The Working Group may wish to decide, as a matter of policy, whether draft article 13 should address both certificates and signatures.

REFERENCES TO NATIONAL LEGISLATION AND OTHER TEXTS

EC Directive

Article 7. International aspects

1. Member States shall ensure that certificates which are issued as qualified certificates to the public by a certification-service provider established in a third country are recognized as legally equivalent to certificates issued by a certification-service provider established within the Community if:

(a) the certification-service provider fulfils the requirements laid down in this Directive and has been accredited under a voluntary accreditation scheme established in a member State; or

(b) a certification-service provider established within the Community which fulfils the requirements laid down in this Directive guarantees the certificate; or

(c) the certificate or the certification-service provider is recognized under a bilateral or multilateral agreement between the Community and third countries or international organizations.

2. In order to facilitate cross-border certification services with third countries and legal recognition of advanced electronic signatures originating in third countries, the Commission shall make proposals, where appropriate, to achieve effective implementation of standards and international agreements applicable to certification services. In particular, and where necessary, it shall submit proposals to the Council for appropriate mandates for the negotiation of bilateral and multilateral agreements with third countries and international organizations. The Council shall decide by qualified majority.

Germany

§15 Foreign certificates

(1) Digital signatures which may be checked with a public signature key for which a foreign certificate of another member State of the European Union or of another contracting State of the Treaty on the European Economic Area exists are equivalent to digital signatures under this law, insofar as they demonstrate an equivalent level of security.

(2) Paragraph 1 also applies to other States, insofar as supranational or international agreements concerning the recognition of certificates have been concluded.

Illinois

Article 25. State agency use of electronic signatures and records

Section 25-115. Interoperability

To the extent reasonable under the circumstances, rules adopted by the Department of Central Management Services or a state agency relating to the use of electronic records or electronic signatures shall be drafted in a manner designed to encourage and promote consistency and interoperability with similar requirements adopted by government agencies of other States and the Federal government.

Singapore

Part X. Regulation of certification authorities

Recognition of foreign certification authorities

43. The Minister may by regulations provide that the controller may recognize certification authorities outside Singapore that satisfy the prescribed requirements for any of the following purposes:

(a) the recommended reliance limit, if any, specified in a certificate issued by the certification authority;

(b) the presumption referred to in sections 20*(b)*(ii) [digital signature to be treated as secure electronic signature in certain circumstances] and 21 [presumption of correctness of certificate if accepted by subscriber].

ANNEX

I. DRAFT UNIFORM RULES ON ELECTRONIC SIGNATURES

(Consolidated text of draft articles 1 to 13, as considered in part II of this note)

Article 1. *Sphere of application*

These Rules apply *where* electronic signatures *are* used in the context* of commercial** *activities* and do not override any *rule of* law intended for the protection of consumers.

The Commission suggests the following text for States that might wish to extend the applicability of these Rules:

"These Rules apply where electronic signatures are used, except in the following situations: [...]."

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

Article 2. *Definitions*

For the purposes of these Rules:

(a) "Electronic signature" means [data in electronic form in, affixed to, or logically associated with, a data message, and] *[any method in relation to a data message]* that may be used to identify the signature device holder in relation to the data message and indicate the signature device holder's approval of the information contained in the data message;

[(b) "Enhanced electronic signature" means an electronic signature in respect of which it can be shown, through the use of a [security procedure] [method], that the signature:

(i) is unique to the signature device holder [for the purpose for][within the context in] which it is used;

(ii) was created and affixed to the data message by the signature device holder or using a means under the sole control of the signature device holder *[and not by any other person];*

(iii) was created and is linked to the data message to which it relates in a manner which provides reliable assurance as to the integrity of the message";]]

(c) "Certificate" means a data message or other record which is issued by an information certifier and which purports to *ascertain* the identity of a person or entity who holds a particular [key pair] *[signature device]*;

(d) "Data message" means information generated, sent, received or stored by electronic, optical or similar means including, but not limited to, electronic data interchange (EDI), electronic mail, telegram, telex or telecopy;

(e) "Signature holder" *[device holder] [key holder] [subscriber] [signature device holder] [signer] [signatory]* means a person by whom, or on whose behalf, an enhanced electronic signature can be created and affixed to a data message;

(f) "Information certifier" means a person or entity which, in the course of its business, engages in [providing identification services] [certifying information] which [are][is] used to support the use of [enhanced] electronic signatures.

Article 3. *[Technology neutrality] [Equal treatment of signatures]*

None of the provisions of these Rules shall be applied so as to exclude, restrict, or deprive of legal effect any method [of *electronic* signature] [that satisfies the requirements *referred to in article 6(1) of these Rules*] [*which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement*] [*or otherwise meets the requirements of applicable law*].

Article 4. *Interpretation*

(1) In the interpretation of these Uniform Rules, regard is to be had to their international origin and to the need to promote uniformity in their application and the observance of good faith.

(2) Questions concerning matters governed by these Uniform Rules which are not expressly settled in them are to be settled in conformity with the general principles on which these Uniform Rules are based.

Article 5. *[Variation by agreement] [Party autonomy] [Freedom of contract]*

These Rules may be derogated from or [their effect may be] varied by agreement, unless otherwise provided in these Rules or in the law of the enacting State.

Article 6. *[Compliance with requirements for signature] [Presumption of signing]*

(1) Where the law requires a signature of a person, that requirement is met in relation to a data message if *[a method] [an electronic signature]* is used which is as reliable as was appropriate for the purpose for which the data message was generated or communicated, in the light of all the circumstances, including any relevant agreement.

(2) Paragraph (1) applies whether the requirement referred to therein is in the form of an obligation or whether the law simply provides consequences for the absence of a signature.

Variant A

(3) *It is presumed that [a method] [an electronic signature] is reliable for the purpose of satisfying the requirement referred to in paragraph (1) if that method ensures that:*

(a) the data used for the creation of an electronic signature are unique to the holder of the signature [creation] device within the context in which they are used;

(b) the holder of the signature [creation] device [has] [had at the relevant time] sole control of that device;

(c) the electronic signature is linked to the [information] [the data message or the part of that message] to which it relates [in a manner which guarantees the integrity of that information];

(d) the holder of the signature [creation] device is objectively identified within the context [in which the device is used][of the data message].

Variant B

(3) *In the absence of proof to the contrary, the use of an electronic signature is presumed to prove:*

(a) that the electronic signature meets the standard of reliability set out in paragraph (1);

(b) the identity of the alleged signer; and

(c) that the alleged signer approved the information to which the electronic signature relates.

(4) *The presumption in paragraph (3) applies only if:*

(bbb) the person who intends to rely on the electronic signature notifies the alleged signer that the electronic signature is being relied upon [as equivalent to the hand-written signature of the alleged signer][as proof of the elements listed in paragraph (3)]; and

(ccc) the alleged signer fails to notify promptly the person who issues a notification under subparagraph (a) of the reasons for which the electronic signature should not be relied upon [as equivalent to the hand-written signature of the alleged signer][as proof of the elements listed in paragraph (3)].

Variant C

(3) *In the absence of proof to the contrary, the use of an electronic signature is presumed to prove:*

(a) that the electronic signature meets the standard of reliability set out in paragraph (1);

(b) the identity of the alleged signer; and

(c) that the alleged signer approved the information to which the electronic signature relates.

[(4)][(5)] The provisions of this article do not apply to the following: [...].

[Article 7. *Presumption of original*

(1) *A data message is presumed to be in its original form where*, in relation to *that* data message, [a method] *[an electronic signature] [within article 6]* is used which:

(a) provides a reliable assurance as to the integrity of the information from the time when it was first generated in its final form, as a data message or otherwise; and

(b) where it is required that information be presented, that information is capable of being displayed to the person to whom it is to be presented;

(2) The provisions of this article do not apply to the following: [...].]

Article 8. *Satisfaction of articles 6 and 7*

Variant A

(1) *[The organ or authority specified by the enacting State as competent]* may determine which methods satisfy the requirements of articles 6 and 7.

(2) Any determination made under paragraph (1) *shall* be consistent with recognized international standards.

Variant B

(1) *One or more methods of electronic signature may be determined as satisfying the requirements of articles 6 and 7.*

(2) Any determination made under paragraph (1) *shall* be consistent with recognized international standards.

Article 9. *Responsibilities of the signature device holder*

(1) *Each* signature *device* holder shall:

(a) Exercise reasonable care to avoid unauthorized use of its signature device;

(b) Notify appropriate persons without undue delay if:

(i) the signature device holder knows that the signature device has been compromised; or

(ii) the circumstances known to the signature device holder give rise to a substantial risk that the signature device may have been compromised;

(c) [Where a certificate is used to support the signature device,] [Where the signature device involves the use of a certificate,] exercise *reasonable care* to ensure the accuracy and completeness of all material representations made by the signature *device* holder which are relevant to *[the life-cycle of the]* certificate, or which are *to be* included in the certificate.

(2) A signature device holder shall be liable for its failure to satisfy the requirements of paragraph (1).

Article 10. *Responsibilities of a supplier of certification services*

(1) A *supplier of certification services* shall:

(a) act in accordance with the representations it makes with respect to its practices;

(b) exercise due diligence to ensure the accuracy and completeness of all material representations made by the supplier of certification services that are relevant to the life-cycle of the certificate or which are included in the certificate;

(c) provide reasonably accessible means which enable a relying party to ascertain:

(i) the identity of the *supplier of certification services*;

(ii) that the person who is identified in the certificate holds, at the relevant time, the signature device referred to in the certificate;

(iii) the method used to identify the signature *device* holder;

(iv) any limitations on the purposes or value for which the signature device may be used; and

(v) whether the signature device is valid and has not been compromised;

(d) provide a means for signature *device* holders to give notice that a *signature device* has been compromised and ensure the operation of a timely revocation service;

(e) utilize trustworthy systems, procedures and human resources in performing its services.

(5) *In determining whether and the extent to which any systems, procedures and human resources are trustworthy for the purposes of subparagraph (e) of paragraph (1), regard shall be had to the following factors:*

(a) financial and human resources, including existence of assets within the jurisdiction;

(b) trustworthiness of hardware and software systems;

(c) procedures for processing of certificates and applications for certificates and retention of records;

(d) availability of information to the [signers][subjects] identified in certificates and to potential relying parties;

(e) regularity and extent of audit by an independent body;

(f) the existence of a declaration by the State, an accreditation body or the supplier of certification services regarding compliance with or existence of the foregoing;

(g) susceptibility to the jurisdiction of courts of the enacting State; and

(h) the degree of discrepancy between the law applicable to the conduct of the supplier of certification services and the law of the enacting State.

(3) A certificate shall state:

(a) the identity of the supplier of certification services;

(b) that the person who is identified in the certificate holds, at the relevant time, the signature device referred to in the certificate;

(c) that the signature device was effective at or before the date when the certificate was issued;

(d) any limitations on the purposes or value for which the certificate may be used; and

(e) any limitation on the scope or extent of liability which the supplier of certification services accepts to any person.

Variant X

(4) A supplier of certification services shall be liable for its failure to satisfy the requirements of paragraph (1).

(5) Liability of the supplier of certification services may not exceed the loss which the supplier of certification services foresaw or ought to have foreseen at the time of its failure in the light of facts or matters which the supplier of certification services knew or ought to have known to be possible consequences of the supplier of certification services' failure to [fulfil the obligations [duties] in][satisfy the requirements of] paragraph (1).

Variant Y

(4) A supplier of certification services shall be liable for its failure to satisfy the requirements of paragraph (1).

(5) In assessing the loss, regard shall be had to the following factors:

(a) the cost of obtaining the certificate;

(b) the nature of the information being certified;

(c) the existence and extent of any limitation on the purpose for which the certificate may be used;

(d) the existence of any statement limiting the scope or extent of the liability of the supplier of certification services; and

(e) any contributory conduct by the relying party.

Variant Z

(4) If damage has been caused as a result of the certificate being incorrect or defective, a supplier of certification services shall be liable for damage suffered by either:

(a) a party who has contracted with the supplier of certification services for the provision of a certificate; or

(b) any person who reasonably relies on a certificate issued by the supplier of certification services.

(5) A supplier of certification services shall not be liable under paragraph (2):

(a) if, and to the extent, it included in the certificate a statement limiting the scope or extent of its liability to any *relevant* person; or

(b) if it proves that it [was not negligent][took all reasonable measures to prevent the damage].

Article 11. *Reliance on electronic signatures*

(1) A person is not entitled to rely on *an electronic signature* to the extent that it is not reasonable to do so.

(6) [In determining whether reliance is not reasonable,] *[In determining whether it was reasonable for a person to have relied on the electronic signature,*] regard shall be had, if appropriate, to:

(a) the nature of the underlying transaction that the electronic signature was intended to support;

(b) whether the relying party has taken appropriate steps to determine the reliability of the electronic signature;

(c) whether the relying party took steps to ascertain whether the electronic signature was supported by a certificate;

(d) whether the relying party knew or ought to have known that the electronic signature *device* had been compromised or revoked;

(e) any agreement or course of dealing which the relying party has with the subscriber, or any trade usage which may be applicable;

(f) any other relevant factor.

Article 12. *Reliance on certificates*

(1) A person is not entitled to rely on *the information in* a certificate to the extent that it is not reasonable to do so.

(2) In determining whether reliance is not reasonable,] *[In determining whether it was reasonable for a person to have relied on the information in a certificate,*] regard shall be had, if appropriate, to:

(a) any restrictions placed upon the certificate;

(b) whether the relying party has taken appropriate steps to determine the reliability of the certificate, including reference to a certificate revocation *or suspension* list where relevant;

(c) any agreement or course of dealing which the relying party has *or had at the relevant time* with the supplier of certification services or subscriber or any trade usage which may be applicable;

(d) any other relevant factors.

Variant A

(3) If reliance on the electronic signature is not reasonable in the circumstances having regard to the factors in paragraph (1), a relying party assumes the risk that the signature is not a valid signature.

Variant B

(3) If reliance on the signature is not reasonable in the circumstances having regard to the factors in paragraph (1), a relying party shall have no claim against the signature device holder or the supplier of certification services.

Article 13. *Recognition of foreign certificates and electronic signatures*

[(1) In determining whether, or the extent to which, a certificate [*or an electronic* signature] is legally effective, no regard shall be had to the place where the certificate [*or the electronic* signature] was issued, nor to the State in which the issuer had its place of business.]

(2) Certificates issued by a foreign *supplier of certification services* are recognized as legally equivalent to certificates issued by *suppliers of certification services* operating under ... *[the law of the enacting State]* if the practices of the foreign *suppliers of certification services* provide a level of reliability at least equivalent to that required of *suppliers of certification services* under ... *[the law of the enacting State]*. [Such recognition may be made through a published determination of the State or through bilateral or multilateral agreement between or among the States concerned.]

(3) Signatures complying with the laws of another State relating to electronic signatures are recognized as legally equivalent to signatures under ... *[the law of the enacting State]* if the laws of the other State require a level of reliability at least equivalent to that required for such 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.]

(4) In determining equivalence, regard shall be had, *if appropriate, [to the factors in paragraph (2) of article 10]* [to the following factors:

(a) financial and human resources, including existence of assets within the jurisdiction;

(b) trustworthiness of hardware and software systems;

(c) procedures for processing of certificates and applications for certificates and retention of records;

(d) availability of information to the [signers][subjects] identified in certificates and to potential relying parties;

(e) regularity and extent of audit by an independent body;

(f) the existence of a declaration by the State, an accreditation body or the certification authority regarding compliance with or existence of the foregoing;

(g) susceptibility to the jurisdiction of courts of the enacting State; and

(h) the degree of discrepancy between the law applicable to the conduct of the certification authority and the law of the enacting State].

(5) Notwithstanding paragraphs (2) and (3), parties to commercial and other transactions may specify that a particular *supplier of certification services*, class of *suppliers of certification services* or class of certificates must be used in connection with messages or signatures submitted to them.

(6) *Where, notwithstanding paragraphs (2) and (3), parties agree, as between themselves, to the use of certain types of electronic signatures and certificates,[that agreement shall be recognized as sufficient for the purpose of cross-border recognition]. [In determining whether, or the extent to which, an electronic signature or certificate is legally effective, regard shall be had to any agreement between the parties to the transaction in which that signature or certificate is used.]*

IV. INTERNATIONAL COMMERCIAL ARBITRATION

A. Report of the Working Group on Arbitration on the work of its thirty-second session (Vienna, 20-31 March 2000) (A/CN.9/468) [Original: English]

CONTENTS

I. INTRODUCTION

1. The Commission, during its thirty-first session, held a special commemorative New York Convention Day on 10 June 1998 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 Secretary-General of the United Nations made the opening speech. In addition to speeches by former participants in the diplomatic conference that adopted the Convention, leading arbitration experts gave reports on matters such as the promotion of the Convention, its enactment and application. Reports were also given on matters beyond the Convention itself, such as the interplay between the Convention and other international legal texts on international commercial arbitration and on practical difficulties that were encountered in practice but were not addressed in existing legislative or non-legislative texts on arbitration.[1]

2. In reports presented at that commemorative conference, 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.

3. The Commission, at its thirty-first session in 1998, with reference to the discussions at the New York Convention Day, considered that it would be useful to engage in a discussion of possible future work in the area of arbitration at its thirty-second session in 1999. It requested the secretariat to prepare a note that would serve as a basis for the considerations of the Commission.[2]

4. At its thirty-second session, the Commission had before it the requested note entitled "Possible future work in the area of international commercial arbitration" (document A/CN.9/460). The note drew on ideas, suggestions and considerations expressed in different contexts, such as the New York Convention Day, the Congress of the International Council for Commercial Arbitration (Paris, 3-6 May 1998),[3] and other international conferences and forums, such as the 1998 "Freshfields" lecture.[4] The note discussed some of the issues and problems identified in arbitral practice in order to facilitate a discussion in the Commission as to whether it wished to put any of those issues on its work programme.

5. The Commission welcomed the note by the secretariat and the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration. It was generally considered that the time had arrived to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985) as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.

6. Possible work topics considered by the Commission were the following:

(a) Conciliation (A/CN9/460, paras. 8-19; A/54/17, paras. 340-343).

(b) Requirement of written form (A/CN.9/460, paras. 20-31; A/54/17, paras. 344-350).

(c) Arbitrability (A/CN.9/460, paras. 32-34; A/54/17, paras. 351-353).

(d) Sovereign immunity (A/CN.9/460, paras. 35-50; A/54/17, paras. 354 and 355).

(e) Consolidation of cases before arbitral tribunals (A/CN.9/460, paras. 51-60; A/54/17, paras. 356 and 357).

(f) Confidentiality of information in arbitral proceedings (A/CN.9/460, paras. 62-71; A/54/17, paras. 358 and 359).

(g) Raising claims for the purpose of set-off (A/CN.9/460, paras. 72-79; A/54/17, paras. 360 and 361).

(h) Decisions by "truncated" arbitral tribunals (A/CN.9/460, paras. 80-91; A/54/17, paras. 362 and 363).

(i) Liability of arbitrators (A/CN.9/460, paras. 92-100; A/54/17, paras. 364-366).

(j) Power by the arbitral tribunal to award interest (A/CN.9/460, paras. 101-106; A/54/17, paras. 367-369).

(k) Costs of arbitral proceedings (A/CN.9/460, paras. 107-114; A/54/17, para. 370).

(l) Enforceability of interim measures of protec- tion (A/CN.9/460, paras. 115-127; A/54/17, paras. 371-373).

(m) Possible enforceability of an award that has been set aside in the State of origin (A/CN.9/460, paras. 128-144; A/54/17, paras. 374-376).

7. At various stages of the discussion, several other topics, in addition to those contained in document A/CN.9/460, were mentioned as potentially worthy of being taken up by the Commission at an appropriate future time (A/54/17, para. 339).

8. In its considerations the Commission kept an open mind as to the ultimate form that future work of the Commission might take. It was agreed that decisions as to the form should be taken later as the substance of proposed solutions became clearer. Uniform provisions might, for example, take the form of a legislative text (such as model legislative provisions or a treaty) or a non-legislative text

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[1] *Enforcing Arbitration Awards under the New York Convention: Experience and Prospects* (United Nations publication, Sales No. E.99.V.2).

[2] *Official Records of the General Assembly, Fifty-third Session, Supplement No. 17* (A/53/17), para. 235.

[3] *Improving the Efficiency of Arbitration Agreements and Awards: 40 Years of Application of the New York Convention, International Council for Commercial Arbitration Congress Series No. 9*, Kluwer Law International, 1999.

[4] Gerold Herrmann, "Does the world need additional uniform legislation on arbitration?" *Arbitration International*, vol. 15 (1999), No. 3, page 211.

(such as a model contractual rule or a practice guide). It was stressed that, even if an international treaty were to be considered, it was not intended to be a modification of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). It was thought that, even if ultimately no new uniform text would be prepared, an in-depth discussion by delegates from all major legal, social and economic systems represented in the Commission, possibly with suggestions for uniform interpretation, would be a useful contribution to the practice of international commercial arbitration. The considerations of the Commission on those issues are reflected in document A/54/17 (paras. 337-376 and para. 380).

9. After concluding the discussion on its future work in the area of international commercial arbitration, it was agreed that the priority items for the working group should be conciliation (A/54/17, paras. 340-343), requirement of written form for the arbitration agreement (A/54/17, paras. 344-350), enforceability of interim measures of protection (A/54/17, paras. 371-373) and possible enforceability of an award that had been set aside in the State of origin (A/54/17, paras. 374 and 375). It was expected that the secretariat would prepare the necessary documentation for the first session of the Working Group for at least two, and possibly three, of those four topics. As to the other topics discussed in document A/CN.9/460, as well as topics for possible future work suggested at the thirty-second session of the Commission (A/54/17, para. 339), which were accorded lower priority, the Working Group was to decide on the time and manner of dealing with them.

10. The Commission entrusted the work to a working group to be named "Working Group on Arbitration" and requested the secretariat to prepare the necessary documentation for the meeting.

11. The Working Group on Arbitration, which was composed of all the States members of the Commission, held its thirty-second session at Vienna from 20 to 31 March 2000. The session was attended by representatives of the following States members of the Working Group: Austria, Cameroon, China, Colombia, Egypt, Finland, France, Germany, Honduras, India, Iran (Islamic Republic of), Italy, Japan, Lithuania, Mexico, Nigeria, Russian Federation, Singapore, Spain, Sudan, Thailand, United Kingdom of Great Britain and Northern Ireland and United States of America.

12. The session was attended by observers from the following States: Argentina, Canada, Costa Rica, Cuba, Czech Republic, Denmark, Indonesia, Lebanon, Morocco, Netherlands, Peru, Poland, Portugal, Republic of Korea, Rwanda, Saudi Arabia, Slovakia, Sweden, Switzerland, Turkey, Ukraine and Venezuela.

13. The session was attended by observers from the following international organizations: Economic Commission for Europe, NAFTA Article 2022 Advisory Committee; Permanent Court of Arbitration; Cairo Regional Centre for International Commercial Arbitration; Chartered Institute of Arbitrators; International Chamber of Commerce (ICC); International Federation of Commercial Arbitration Institutions.

14. The Working Group elected the following officers:

Chairman: Mr. José María ABASCAL ZAMORA (Mexico)

Rapporteur: Mr V. G. HEGDE (India)

15. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.II/WP.107) and the report of the Secretary-General entitled "Possible uniform rules on certain issues concerning settlement of commercial disputes: conciliation, interim measures of protection, written form for arbitration agreement" (A/CN.9/WG.II/WP.108 and Add.1).

16. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the agenda.
3. Possible preparation of harmonized texts on conciliation; interim measures of protection; and written form of arbitration agreements.
4. Other business.
5. Adoption of the report.

II. DELIBERATIONS AND DECISIONS

17. The Working Group discussed agenda item 3 on the basis of the report of the Secretary-General (A/CN.9/WG.II/WP.108 and Add.1). The deliberations and conclusions of the Working Group with respect to that item are reflected below.

A. Conciliation

1. General considerations

18. The Working Group took note of statements to the effect that conciliation or mediation was being increasingly used for settling commercial disputes, that the use of such non-contentious methods of dealing with disputes deserved to be promoted and that the work of the Commission in the area should be geared to such promotion. It was noted that conciliation was being used either independently from court or arbitral proceedings or as part of, or in close relationship to, such proceedings and that solutions to be adopted should take that fact into account.

19. It was generally agreed that the term "conciliation" should be understood as a broad notion encompassing various types of proceedings in which a person or a panel of persons was invited by the parties in dispute to assist them in an independent and impartial manner to reach an amicable settlement of the dispute. It was also generally agreed that such proceedings may differ as regards the procedural techniques used to facilitate settlement and that different expressions might be used to refer to such proceedings, such as, for example, "mediation" or other expressions used for non-binding methods of dispute settlement.

20. It was generally considered that decisions as to the form of the text to be prepared should be made at a later stage when the substance of prepared solutions would

become clearer. However, it was noted that model legislative provisions seemed to be the appropriate form for a number of matters proposed to be discussed in the area of conciliation.

21. There was general agreement in the Working Group that the applicability of any uniform rules to be prepared should be restricted to commercial matters. It was suggested that a flexible provision such as the one contained in the footnote to article 1 of the UNCITRAL Model Law on International Commercial Arbitration was an appropriate way for defining which matters were to be considered commercial.

2. Admissibility of certain evidence in subsequent judicial or arbitral proceedings

(A/CN.9/WG.II/WP.108, paras. 18-28)

22. General statements were made that confidentiality of information put forward by the parties during conciliation should be safeguarded. It was noted that confidentiality of information relating to conciliation may become an issue in different contexts: *(a)* in the circumstances dealt with in article 20 of the UNCITRAL Conciliation Rules; *(b)* as a general obligation on the conciliator and the parties to keep confidential all matters relating to the conciliation proceedings (such an obligation was contained in article 14 of the UNCITRAL Conciliation Rules); and *(c)* in the cases where a party gave information to the conciliator subject to a specific condition that it be kept confidential and the conciliator (in line with article 10 of the UNCITRAL Conciliation Rules) was not to disclose that information to the other party. The discussion in the Working Group centred on cases under *(a)*, which were covered by article 20 of the UNCITRAL Conciliation Rules. There was no discussion or decision made to prepare a uniform rule on a general obligation to keep matters relating to the conciliation proceedings confidential (article 14 of the UNCITRAL Conciliation Rules). (As to information given by a party to the conciliator subject to a specific condition that it be kept confidential, see below, paras. 54 and 55).

23. There was wide agreement in the Working Group that article 20 of the UNCITRAL Conciliation Rules provided a good basis for drafting a model legislative provision on the admissibility of certain oral and written evidence in arbitral or judicial proceedings. There was no doubt in the Working Group about the proposition that the provision to be prepared was to be subject to party autonomy.

24. With a view to avoiding too much detail in the model legislative provision, a suggestion was made not to list the types of facts that were to be covered by the provision, but instead to employ a more general wording relying on the applicable national law governing admissibility of evidence. However, caution was expressed that such an approach might not provide sufficient certainty in particular because the applicable law of evidence might itself not be sufficiently clear or because the parties might not be familiar with it.

25. It was considered that the model provision to be prepared should deal with situations where the parties had agreed to a rule such as the one contained in article 20 of the UNCITRAL Conciliation Rules (and thereby give legislative backing to such an agreement) as well as with situations where the parties engaged in a conciliation without having agreed to such a rule. In both cases, it was said, the uniform rule should aim at preventing the "spillover" of certain facts (in particular those mentioned in article 20 of the UNCITRAL Conciliation Rules) into subsequent judicial or arbitral proceedings. As to cases where the parties have not agreed on a rule such as article 20 of the UNCITRAL Conciliation Rules, it was suggested that the model provision should state that it was an implied term of an agreement to conciliate that the parties undertook not to rely in any subsequent arbitral or judicial proceedings on evidence of the types of facts to be specified in the model provision. In order to ensure that such an implied agreement would be given effect by courts and arbitral tribunals, it was suggested that it should also be provided that evidence of facts to be specified in the model provision were not to be admitted in evidence and that disclosure of those facts was not to be ordered by the arbitral tribunal or the court. In that connection, it was also suggested that the model provision should cover cases where views, admissions or proposals made during conciliation proceedings were sought to be raised in subsequent court or arbitral proceedings not by a party who had participated in the conciliation but by a third party such as a sub-contractor of a party.

26. It was suggested it should be made clear that the model provision would apply to facts to be specified in it whether or not they were recorded in a document.

27. For the cases where evidence was offered in contravention of the statutory provision to be prepared, it was considered that the court or the arbitral tribunal should deal with the issue by ordering that such evidence was inadmissible and was to be disregarded. While other sanctions might apply when a party breached the statutory provision on the exclusion of certain evidence, as provided in the applicable law, the model provision did not necessarily have to deal with those sanctions.

28. It was pointed out that any solution should be flexible enough to deal adequately with different circumstances in which parties might participate in conciliation proceedings, including those where the parties attempted to reach settlement in a conciliation during court or arbitral proceedings.

29. It was observed that a party might attempt to present, during court or arbitral proceedings, inadmissible evidence of proposals or views which that party itself had made during earlier conciliation proceedings and mention in that connection also proposals or views that had been made during the conciliation by the other party. It was considered that the model provisions to be prepared should be broad enough to cover such situations.

30. The Working Group requested the secretariat to prepare for its next session draft legislative provisions based on the considerations in the Working Group.

3. Role of conciliator in arbitration or court proceedings

(A/CN.9/WG.II/WP.108, paras. 29-33)

31. On the question of whether a person who had acted as a conciliator could subsequently be appointed as an arbitrator, represent a party in an arbitration or be called as a witness, it was generally agreed that article 19 of the UNCITRAL Conciliation Rules provided a useful starting point for consideration of a possible legislative provision. It was observed that in some States a clear distinction was drawn between the conduct of conciliation and arbitration and there was a concern that, if the conciliator could subsequently act as arbitrator, the parties would be less likely to approach the conciliation openly and share information, potentially jeopardizing its success. In other States the conduct of conciliation and arbitration were not so clearly distinguished.

32. As a preliminary point, it was suggested that the roles referred to in article 19 (arbitrator, representative or counsel, witness) should be treated separately, since each raised different considerations. It was also suggested that, while some of those issues could appropriately be addressed in a statutory provision, others might best be addressed by, for example, codes of conduct or ethics. The view was expressed that in the context of the conciliator acting as representative of a party, the general position should be a prohibition, subject to contrary agreement by the parties. That approach would encourage frank exchanges between the parties and protect the confidentiality and integrity of conciliation and arbitration processes. Ethical considerations might also be relevant in that context.

33. In the context of the conciliator appearing as a witness, it was suggested that the general position should also be a prohibition against parties or others compelling such testimony, although there might be a need for exceptions. Circumstances in which that might be necessary could include, for example, proceedings to enforce the settlement agreement where it was alleged that the agreement was fraudulently obtained. In that regard, however, it was pointed out that fraud might be either civil or criminal in nature and raise questions of national law. Any exceptions to the general rule would need to be carefully considered. It was also noted, in the context of witnesses, that considerations relating to witnesses appearing in arbitral proceedings might be different to those applicable to judicial proceedings. In addition, concern was expressed as to the extent to which, firstly, parties could agree to exclude a witness from subsequent proceedings, whether arbitral or judicial, and secondly, an undertaking on the part of the conciliator not to appear would always be effective in all circumstances.

34. As to the question of a conciliator acting as an arbitrator, it was suggested that that should also be prohibited unless otherwise agreed by the parties. It was noted, however, that in some cases there might be ethical considerations which would suggest that the conciliator should decline to act.

35. General support was expressed in favour of a rule which provided that, unless otherwise agreed by the parties, the conciliator could not perform those roles. It was observed that the benefit of establishing a statutory provision to that effect would be to ensure that the agreement between the parties was given full effect and observed by all relevant parties and institutions, including the appointing authority and a court. Some support was also expressed in favour of a rule providing that the parties would be deemed to have agreed that the conciliator should not act.

36. A further question was raised concerning extension of the restrictions on the conciliator beyond the actual case considered in the conciliation to cases on related contracts or other disputes arising from the same contract as discussed in paragraph 33 of document A/CN.9/WG.II/WP.108. It was suggested that that issue was very complex and raised difficult drafting issues of how the relationship between the different contracts and disputes could be defined. It was pointed out that an examination of the facts of each case would be necessary to determine, for example, the extent to which a dispute raised issues relating to the main contract and the extent to which the conciliator was required to consider issues central to that contract. Another view was that disclosure requirements or codes of ethics were more appropriate to address the issues raised by such considerations. Although some support was expressed for omitting the issue from statutory rules, the general view was that the secretariat should be requested to consider it further to see if an appropriate general formulation could be found.

37. After discussion, the Working Group agreed that a provision based upon article 19 should be drafted taking into account the discussions of the Working Group.

4. Enforceability of settlement agreements reached in conciliation proceedings

(A/CN.9/WG.II/WP.108, paras. 34-42)

38. The Working Group discussed the question whether a settlement reached during a conciliation should be treated as an enforceable title as, or similarly to, arbitral awards. Views were divided on the question. According to one view, it was desirable to increase the attractiveness of conciliation, and therefore settlements reached during conciliation should be given the effect of an enforceable title. A number of States had adopted legislation to that effect and it was considered desirable to take into account their good experience and prepare a harmonized model provision for other States that might wish to enact it.

39. According to another view, it was not feasible, notwithstanding the desirability of promoting the use of conciliation, to prepare a workable uniform rule and that therefore the matter should be left to non-harmonized legislation of States. It was said that it would be difficult to distinguish in a legislative provision between settlements that should be treated as enforceable titles and those that should not enjoy such a special treatment. It was also considered inappropriate to equate settlements reached in conciliation with arbitral awards because of the fundamental differences between arbitration and conciliation. Moreover, in the view of some there was no need to treat settlements reached during a

conciliation as enforceable titles because in many States there were simple ways in which a settlement between parties could be made enforceable (e.g. by converting the settlement into a notarized document or by obtaining a judicial sanction for the settlement). Furthermore, if the parties wanted to make their settlement an enforceable title, it was often not overly cumbersome for them to initiate arbitral proceedings with the sole purpose of converting the settlement into an arbitral award on agreed terms. In response to those arguments it was said that those possibilities did not exist in some countries or were connected with difficulties which parties in international trade might wish to avoid. Furthermore, sometimes the parties did not take advantage of those possibilities at the time the settlement was entered into, and the need to enforce the settlement became apparent only later when a party refused to live up to its part of the settlement. In addition, it was observed that legislation treating settlements reached during conciliation as enforceable titles existed and functioned satisfactorily in a number of States.

40. After discussion, the view prevailed that it would be premature to decide not to prepare the suggested uniform rule and therefore the secretariat was requested to prepare draft provisions, possibly with variants, to be considered by the Working Group at its next session. Those provisions should address enforcement, irrespective of the country in which the settlement was made. Several suggestions were made regarding the preparation of the drafts. One was that the settlement agreement should be made in writing or a form equivalent to writing and that it should be signed or authenticated by the parties and the conciliator. Another suggestion was that such settlement agreements should be made subject to the legislative provisions governing the recognition and enforcement of arbitral awards. A further suggestion was, instead of subjecting settlements reached in conciliation to provisions on arbitral awards, to prepare a special provision on settlements reached in conciliation; in drafting such a provision, articles 35 and 36 of the UNCITRAL Model Law on International Commercial Arbitration provided a good model. In discussing that suggestion a proposal was made to adapt article 36 of the Model Law to the characteristics of settlements reached in a conciliation; the proposal was to reduce the grounds on which the recognition or enforcement of a settlement may be refused to an incapacity of a party and a violation of public policy. Non-arbitrability of a dispute was mentioned as a further possible ground for refusal to recognize or enforce a settlement. The procedure under which a settlement agreement would be enforced was considered by some to be a matter to be left to the law of the State in question.

5. Other possible items for harmonized treatment

(a) Admissibility or desirability of conciliation by arbitrators

(A/CN.9/WG.II/WP.108, paras. 44-48)

41. The Working Group noted that there was a wide diversity of views as to the desirability of an arbitrator acting as a conciliator in arbitration proceedings and the attendant difficulty of achieving a common solution. One view was that a distinction should be drawn between an arbitrator recommending the use of a conciliator to reach a settlement and the arbitrator actually performing that function him or herself. While recommending the use of a conciliator should be encouraged, since the arbitrator would be in a unique position to decide whether such a step was appropriate and likely to be successful, the arbitrator acting as a conciliator was not desirable on the basis that different skills and qualities were required to perform the two functions. It was also suggested that such a practice might lead to procedural difficulties, including where an arbitrator acting as conciliator was involved in recommending the terms and conditions of a settlement which was then rejected, leaving that person to arbitrate the dispute. It was noted in response to those objections that in those jurisdictions and institutions where the practice was permitted, there was little evidence of disruption to the dispute resolution process in the cases where it had occurred.

42. An alternative view was that the arbitrator should be permitted to act as a conciliator and, under the national law of a number of countries, an arbitrator in fact had a duty to try to conciliate a dispute referred to arbitration. It was suggested that because the arbitrator was in a unique position to know the facts and circumstances of the case, it was the most cost effective option for the arbitrator to act as the conciliator, rather than referring the parties to a conciliator external to the arbitration proceedings, who would not have the same familiarity with the case and would have to start from the beginning.

43. A further distinction was noted between the situation where an arbitrator took the initiative to conciliate and where the parties requested the arbitrator to conciliate. The view was expressed that emphasis should be placed upon party autonomy and only where the parties agreed should the arbitrator be permitted to act as conciliator.

44. As to the desirability of formulating a legislative provision on the issue, one view was that it should not be the purpose of the work of the Commission to unify arbitration and conciliation practices and that therefore no uniform rule should be prepared. Another view, however, was that it would be worthwhile to prepare a uniform rule whose purpose would be to recognize party autonomy and to clarify that it was not incompatible with the role of the arbitral tribunal to raise the question of a possible conciliation and, to the extent agreed by the parties, to participate in the efforts to reach an agreed settlement. It was agreed that the secretariat should prepare a draft provision along those lines, possibly with alternatives.

(b) Effect of an agreement to conciliate on judicial or arbitral proceedings

(A/CN.9/WG.II/WP.108, paras. 49-52)

45. The Working Group considered the question whether, when the parties agreed to resolve a dispute by conciliation (as opposed to arbitration or court proceedings), it was advisable for the law to regard that agreement as binding in the sense that a party was not free to initiate arbitration or court proceedings until it complied with its commitment to conciliate.

46. Some support was expressed for the position that, in view of the fact that conciliation was seen as a preferred method of settling disputes, the law should treat conciliation agreements as binding; therefore, a uniform provision to that effect should be prepared.

47. However, the prevailing view was that conciliation should be regarded as a voluntary process in that the parties should be obliged to conciliate only if, and as long as, they believed that there was hope that a settlement could be achieved. Any notion that there should be a "paralysis" of arbitral or court proceedings until the parties went through the process of conciliation was bound to result in more difficulty than benefit and that therefore no uniform rule treating conciliation agreements as binding should be prepared. Pursuant to those views, one suggested conclusion was that no uniform provision was necessary, since conciliation rules (such as art. 15 of the UNCITRAL Conciliation Rules) generally allowed a party to terminate conciliation proceedings. Another suggested conclusion was that it might be useful to have a uniform legislative provision that would clarify that a party was free to terminate conciliation proceedings. A view was expressed that a uniform provision should clarify that if during conciliation proceedings a party commenced arbitral or court proceedings that act should be deemed as terminating conciliation proceedings.

48. Some support was expressed for a provision which would recognize the effectiveness of an express agreement of the parties limiting their own freedom to commence arbitral or court proceedings until they complied with their obligation to conciliate.

49. After discussion, the secretariat was requested to prepare alternative versions of a uniform provision reflecting the views of the Working Group.

(c) Effect of conciliation on the running of the limitation period

(A/CN.9/WG.II/WP.108, paras. 53-55)

50. The Working Group discussed the question of whether it would be desirable to prepare a uniform rule providing that the initiation of conciliation proceedings would interrupt the running of limitation and prescription periods concerning the claims involved in the conciliation.

51. Some support was expressed for the preparation of such a uniform provision. It was said that the situation created by such a provision was preferable to a situation where a party was compelled to initiate arbitral or court proceedings only for the purpose of preserving its rights. Formulating such a provision was desirable as a measure to foster the use of conciliation and protect the legitimate interests of parties engaging in it.

52. However, while expressing sympathy for the objectives of the proposed provision, doubts were voiced as to its feasibility. The grounds included the following: it would be difficult to define the moment when conciliation proceedings commenced, which was the moment triggering the interruption of a limitation or prescription period; it would be difficult to define the moment conciliation proceedings ended, which was the moment the limitation or prescription period continued to run; the proposed uniform provision would touch upon national rules of procedure (some of which were of a mandatory nature), an area where the readiness of States to accept unified concepts was not as great as in the area of substantive rules; and it would be necessary to resolve the relationship between the proposed uniform provision and international treaties governing limitation periods.

53. After discussion, and recognizing the difficulties involved in formulating a widely acceptable provision on the issue under discussion, the Working Group considered that it would be worthwhile to study the matter further. It was suggested that the rule would be more acceptable if the prescription or limitation period was suspended as a result of conciliation proceedings and would continue to run after the conciliation proceedings had ended. The secretariat was requested to prepare a draft, possibly with alternatives, to be considered by the Working Group at its next session.

(d) Communication between the conciliator and parties; disclosure of information

(A/CN.9/WG.II/WP.108, paras. 56-60)

54. The Working Group discussed the question of whether it would be desirable to prepare a uniform provision clarifying that it was consistent with the principles of equality between the parties *(a)* if the conciliator met either with the parties together or with each of the parties separately, and *(b)* if the conciliator did not disclose to all parties the information that he or she received from one party subject to a specific condition that it be kept confidential. It was noted that such a manner of proceeding was expressly dealt with in articles 9 and 10 of the UNCITRAL Conciliation Rules. A view was expressed that the provisions of a model law should be more flexible than article 10 in order not to restrict conciliators from using a variety of techniques that were useful in practice.

55. There was agreement in the Working Group that a provision along those lines would be useful because it would provide welcome clarification of the flexible nature of the conciliation process and remove any doubts as to the propriety of procedures such as those covered by articles 9 and 10 of the UNCITRAL Conciliation Rules. The secretariat was requested to prepare draft provisions for the next session of the Working Group using as starting points the referance to articles 9 and 10 of the Rules.

(e) Role of conciliator

(A/CN.9/WG.II/WP.108, paras. 61 and 62)

56. There was general agreement in the Working Group that it would be useful to prepare a uniform provision setting out the guiding principles of conciliation proceedings. Such a general provision would contribute to harmonizing standards of conciliation and would also be helpful in defining conciliation proceedings to which other uniform provisions on conciliation to be prepared by the Commission

would apply. It was agreed that article 7 of the UNCITRAL Conciliation Rules was a good basis for drafting the uniform provision.

57. The following suggestions were made concerning the drafting of the provision: to add facilitation of international trade as one of the objectives of conciliation; to refer to "ethics" in the wording modelled on paragraph 2 of article 7 of the UNCITRAL Conciliation Rules; to delete reference to "the rights and obligations of the parties", because in conciliation, unlike arbitration, settlement might be sought on bases other than legal rights and obligations (e.g. business interests of the parties); and to include reference to the "law" in the wording modelled on paragraph 2 of article 7 to avoid the implication that the applicable law was not relevant in seeking a settlement.

58. The Working Group requested the secretariat to prepare a draft provision based on article 7 of the UNCITRAL Conciliation Rules. As to the proposed changes in the text modelled on article 7, the Working Group did not take any firm position but it was widely considered that, on balance, it was preferable not to deviate from the substance of article 7, which was tested in practice, was widely used as a model in non-legislative as well as legislative texts and was considered to be an appropriate expression of the essence of conciliation proceedings.

59. The Working Group considered additional topics which might be included in uniform provisions on conciliation. A number of matters were raised which the Working Group felt required further study and elaboration. Those included further work to clarify the scope of application of the uniform provisions, with particular focus on the nature of the agreement to conciliate and the general definition of the notion of such a procedure; the extent to which the agreement to conciliate might be considered to be binding; procedural issues such as selection of the conciliator, date, time and place of conciliation, pre-conciliation exchange of documents, termination of conciliation, and liability of conciliators; issues particular to ad hoc as opposed to institution annexed or administered conciliation; and the need for, and the principles and issues to be included in, a preamble to the uniform provisions with the aim of promoting its use in the resolution of international commercial disputes. It was also suggested that the formulation of a code of ethics for conciliators might be considered by the Working Group to build confidence in the conciliation process by distilling issues from the best traditions and openly enunciating standards of practice. The secretariat was requested to further study those issues based upon the discussion in the Working Group and to prepare material for consideration at a future session of the Working Group.

B. Enforceability of interim measures of protection

(A/CN.9/WG/WP.108, paras. 63-101)

1. General considerations

60. There was general recognition in the Working Group of the fact that interim measures of protection were increasingly being found in the practice of international commercial arbitration and that the effectiveness of arbitration as a method of settling commercial disputes depended on the possibility of enforcing such interim measures. In some cases the very usefulness of the award for the winning party depended on whether the party had been able to enforce the interim measure designed to facilitate later enforcement of the award.

61. It was noted that in many legal systems a party to arbitral proceedings might request interim measures of protection from either the arbitral tribunal or a court, and there was no doubt in the Working Group that such a dual availability of those measures should be preserved. At the same time, it was noted that in some States there were no adequate regulations in that field.

62. It was observed that interim measures of protection ordered by arbitral tribunals were often combined with orders for the provision of appropriate security designed to protect one or both parties against misuse of interim measures. Such security was considered essential for the good functioning of interim measures and it was agreed that the uniform provisions to be prepared should take that into account.

63. A proposal was made, in particular, for elaboration of a general regime covering the adoption of interim measures of national and foreign courts in the period before the arbitral tribunal had been constituted and, at the choice of a party, by a court or the arbitral tribunal after it had been constituted (see below, paras. 85-87).

64. It was further observed that interim measures of protection were temporary in nature in that any such measure ordered by an arbitral tribunal might be reviewed or altered if the circumstances of the case or the progress of arbitral proceedings required. That salient feature should be reflected in any uniform provision to be prepared. Yet another circumstance to be borne in mind was that interim measures of protection ordered by an arbitral tribunal may only be directed to a party or parties bound by the arbitration agreement and not to third parties. On the other hand, it was noted that, even if not directed at a third party, an interim measure may nevertheless affect third persons holding, for example, money or other assets of the party concerned, since they may be obliged to take some action in respect of that property by virtue of the order directed to the party.

65. It was noted that under the procedures used in some jurisdictions the arbitral tribunal might order a party to make an "interim payment" or "interim partial payment" to the other party (insofar as it was beyond doubt that the amount of the interim payment was due) and that such payment was to be merged into the final award. There was general agreement that such orders for interim payment were not to be considered interim measures of protection as discussed by the Working Group and were not to be a subject matter of any uniform provisions to be prepared.

66. At various stages of the discussion of enforceability of interim measures of protection reference was made to the power of the arbitral tribunal to issue such measures, the scope of that power and procedures for issuing interim

measures. Noting that a model legislative provision dealing with that power was contained in article 17 of the UNCITRAL Model Law on International Commercial Arbitration, it was recognized that the issue of enforceability of interim measures of protection should be considered separately from the issue of the power of the arbitral tribunal to order interim measures of protection and related procedural questions. (See below, paras. 80-84, for the discussion on the scope of interim measures that may be issued by an arbitral tribunal and conditions for issuance.)

2. Need for a uniform regime

67. There was general support in the Working Group for the proposition to prepare a legislative regime governing the enforcement of interim measures of protection ordered by arbitral tribunals (document A/CN.9/WG.II/WP.108, para. 76). It was generally considered that that legislative regime should apply to enforcement of interim measures issued in arbitrations taking place in the State where enforcement was sought as well as outside that State (ibid., para. 92).

68. It was noted that a number of States had adopted legislative provisions dealing with the court enforcement of interim measures, and it was considered desirable that a harmonized and widely acceptable regime be prepared by the Commission.

69. During the discussion reference was often made to paragraph 63 of document A/CN.9/WG.II/WP.108, which distinguished three groups of interim measures of protection: *(a)* measures aimed at facilitating the conduct of arbitral proceedings, *(b)* measures to avoid loss or damage and measures aimed at preserving a certain state of affairs until the dispute is resolved, and *(c)* measures to facilitate later enforcement of the award. While noting that that classification was one of a number of possible alternatives and that the examples of measures given under each category were not exhaustive, it was pointed out that the need for an enforcement mechanism was the greatest for measures under *(c)* (e.g. attachments of assets, orders not to remove the subject matter of the dispute out of the jurisdiction or orders to provide security) and for some of the measures under *(b)* (e.g. orders to continue performing a contract during the arbitral proceedings or orders to refrain from taking an action until the award was made). As to measures under *(a)* it was noted that, because the arbitral tribunal might "draw adverse conclusions" from the failure of the party to comply with the measure or might take the failure into account in the final decision on costs of the arbitral proceedings, there was less need to seek court intervention in the enforcement of the measure. However, no firm view was reached at that stage of the discussion as to whether, and if so in what way, those differences among interim measures should influence the drafting of the future enforcement regime.

3. Elements of a possible uniform provision

70. Various views were expressed as to whether the court requested to enforce an interim measure of protection should have discretion in making its decision concerning enforcement and, if so, what should be the extent of that discretion. Under one view, there should be no discretion in enforcing the measure, similar to the obligation of the court to enforce an arbitral award if the conditions of articles 35 and 36 of the UNCITRAL Model Law (or articles IV and V of the 1958 New York Convention) were met. Under another view, which received considerable support, it was felt that the regime contained in articles 35 and 36 of the UNCITRAL Model Law was too rigid and did not take into account the special features of interim measures of protection which distinguished them from arbitral awards and which called for a degree of flexibility to be built into the uniform regime to be prepared. Those special features included the following: the temporary nature of interim measures and the resulting possibility that the measures might have to be modified or terminated; the need to adapt the interim measure to the enforcement procedures of the enforcing court; the possibility that the measure would affect the interests of third parties; and the possibility that the measure might have been issued ex parte (i.e. on the application of one party without hearing the other affected party) and that the requirement that both parties be heard would have to be complied with after the issuance of the interim measure.

71. There was broad agreement in the Working Group that the uniform regime should be based on the assumption that the court should not repeat the decision-making process in the arbitral tribunal that led to the issuance of the measure; in particular, the court should not review the factual conclusions of the arbitral tribunal or the substance of the measure. The court's discretion should be limited to procedural aspects of the enforcement of the measure. In that context the view was expressed that often it was not clear whether an issue was to be considered procedural or substantive and that the distinction was prone to controversy; therefore, it was desirable to avoid making the distinction, and, for that reason, the enforcement regime for interim measures should track as closely as possible the regime governing the enforcement of awards. Another view was that the scope of procedural discretion should be narrowly circumscribed so that the enforcement process would not be delayed and the court would not repeat the decision-making process of the arbitral tribunal. Under yet another view, it was difficult to be precise in describing the conditions for enforcement and that therefore the legislative provision should be broadly worded.

72. During the discussion of the above views, the Working Group considered possible approaches to the drafting of the uniform provision. One possible approach identified was that the uniform provision should be based on articles 35 and 36 of the UNCITRAL Model Law. The advantage of that approach was that the regime was known and tested in practice. It was also said that orders for interim measures, irrespective of whether called provisional awards or orders, were different from final awards. For that reason, articles 35 and 36 were not a suitable basis for an enforcement regime for interim measures of protection as those articles referred to a regime for enforcement of arbitral awards. It was, however, noted in response that interim measures of protection were in practice issued in different forms and under different labels, which included interim

awards (see, e.g. arts. 26(2) and 32(1) of the UNCITRAL Arbitration Rules), and that the form in which the interim measure of protection was issued should not influence the decision whether articles 35 and 36 were a suitable basis for a regime of enforcement of interim measures of protection. Under another approach, the uniform provision would not list the grounds on which the court might refuse to enforce the measure, but would deal with issues such as the possibility of recasting the interim measure by the court; the possibility that the court might, upon request, repeal or amend its own decision to enforce the interim measure; the obligation by the party who obtained the enforcement of the measure to compensate the other party if the measure proved to have been unjustified from the outset; and a clarification that such a claim for compensation could be put forward in the pending arbitral proceedings. A further possible approach was to formulate a general provision which would be limited to providing that, if the party did not comply with the interim measure voluntarily, the competent court may be requested to render an enforcement order. Such a general provision might be complemented by provisions regarding the law to be applied by the court and security to be provided by a party. It was noted that all three approaches had been used in national laws and that the future uniform provision might be inspired by all of them. It was noted, in particular, that the second or third approach may be effected, for example, by adding to article 17 of the Model Law a general provision that a court should enforce the interim measure imposed by the arbitral tribunal; articles 35 and 36 would remain solely applicable to the enforcement of a final award.

73. It was said that any solution must be efficient and that, to the extent flexibility ought to be a factor, it was desirable to minimize the possibility of delay. It was considered that giving discretion to the court meant opening the scope for argument and delay. That consideration was said to be a further reason in favour of adopting the regime of articles 35 and 36 of the UNCITRAL Model Law. However, it was stated in response that, if properly defined, flexibility and discretion were desirable and that such flexibility did not necessarily increase the scope for delay; moreover article 36 of the Model Law might be said to give scope for delay such as when the party raised objections that the arbitration agreement was not valid, that proper notice was not given of the appointment of an arbitrator or of the arbitral proceedings or that the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties or the law of the country where the arbitration took place (art. 36(1)*(a)*(i), (ii) or (iv) of the Model Law).

74. In discussing how the enforcement regime of interim measures of protection should reflect the fact that such measures were temporary (in that the circumstances on the basis of which a particular measure was ordered by the arbitral tribunal might change by the time the court considered the request for enforcement or even thereafter), it was noted that the UNCITRAL Model Law on Cross-Border Insolvency dealt with the recognition of a foreign insolvency proceeding, whose status might also change over time and that some of the solutions in that Model Law might serve as an inspiration in devising the enforcement regime of interim measures of protection. The relevant provisions in the Model Law were contained in articles 17(4), 18 and possibly 22(2).

75. The Working Group engaged in a preliminary discussion of the question whether it should be only for the interested party to request the enforcement of the interim measure or whether the arbitral tribunal should also have a role in requesting enforcement. The view was expressed that the arbitral tribunal should not be put in a position where it would have to approach a national court with a view to obtaining enforcement of an interim measure ordered by it; thus, the enforcement of interim measures should be left entirely to the interested party. According to another view, however, it was useful to maintain a role for the arbitral tribunal in the enforcement of its measure, e.g. by providing that the request for enforcement could be made with leave of the arbitral tribunal or that the arbitral tribunal itself was able, but not obliged, to request enforcement.

76. An observation was made that the International Convention on Arrest of Ships, 1999, dealt with interim measures of protection and their enforcement and that some of the solutions of the Convention, in particular those in its article 7, might serve as a model in drafting the uniform provisions to be prepared by the Working Group.

77. It was suggested that any regime to be elaborated should not impose substantially more onerous conditions or higher fees or charges on the enforcement of interim measures issued outside the State of the enforcing court than are imposed on the enforcement of interim measures issued in that State (cf. art. III of the New York Convention).

78. The Working Group, in view of the preliminary stage of the discussion, did not take a decision as to the question whether the harmonized regime for the enforcement of interim measures should be in the form of an international convention or in the form of model legislation. While noting the view that the form of a convention was preferable, the Working Group considered that the decision as to the form would be made at a later stage. Notwithstanding that position, much of the discussion in the Working Group proceeded under the assumption that the solutions would be cast in the form of model legislation.

79. The secretariat was requested to prepare alternative draft provisions based on the considerations in the Working Group to be discussed at a future session.

C. Scope of interim measures that may be issued by arbitral tribunal and procedures for issuance

(A.CN.9/WG.II/WP.108, paras. 102-108)

80. The Working Group considered the desirability and feasibility of preparing a harmonized non-legislative text on the scope of interim measures of protection that an arbitral tribunal might order and procedural rules therefor.

81. Wide support was expressed for preparing a non-legislative text, such as guidelines or practice notes, which

would discuss issues such as the types of interim measures of protection that an arbitral tribunal might order, discretion for ordering such measures, and guidelines on how the discretion was to be exercised or the conditions under which, or circumstances in which, such measures might be ordered. It was suggested that clarification provided by such guidelines should be broad in scope and should cover all interim measures of protection mentioned in paragraph 63 of document A.CN.9/WG.II/WP.108 (i.e. *(a)* measures aimed at facilitating the conduct of arbitral proceedings, *(b)* measures to avoid loss or damage and measures aimed at preserving a certain state of affairs until the dispute is resolved, and (c) measures to facilitate later enforcement of the award). However, it was added that the guidelines would be particularly useful for measures with respect to which court enforcement was more frequently needed.

82. An observation was made that guidelines clarifying how the power of arbitral tribunals to order interim measures of protection was exercised would foster the acceptance by States of uniform legislative provisions on enforcement of those measures, which the Working Group had decided to prepare (see above, para. 67). However, it was noted that those uniform legislative provisions would be prepared, and would apply, independently from the future non-legislative text discussing interim measures of protection that might be issued by an arbitral tribunal and procedures for their issuance.

83. It was suggested that in preparing the proposed text account should be taken of the inter-relationship between interim measures that might be ordered by a court and interim measures that might be ordered by the arbitral tribunal (e.g. the question whether a party might request an interim measure from a court after the arbitral tribunal had been constituted and was able to issue the requested measure itself, or whether a party, after unsuccessfully seeking an interim measure from the arbitral tribunal, might request such a measure from the court).

84. It was agreed that the secretariat should prepare a document that would analyse rules and practices regarding interim measures of protection issued by arbitral tribunals and provide elements for the future harmonized non-legislative text. The Working Group was aware that the information needed for the preparation of the document was not readily available and therefore requested the States and international organizations participating in the considerations of the Working Group as well as experts interested in its work to send to the secretariat relevant information (e.g. arbitration rules, academic and practice writings, as well as examples of texts of interim measures of protection ordered omitting the names of parties and other confidential information).

D. Proposal for preparing uniform provisions on court-ordered interim measures of protection in support of arbitration

85. In the context of the discussion of interim measures that might be issued by an arbitral tribunal (see above, paras. 80-84), it was proposed that the Working Group consider preparing uniform rules for situations in which a party to an arbitration agreement turned to a court with a request to obtain an interim measure of protection. It was pointed out that it was particularly important for parties to have effective access to such court assistance before the arbitral tribunal was constituted, but that also after the constitution of the arbitral tribunal a party might have good reason for requesting court assistance. It was added that such requests might be made to courts in the State of the place of arbitration or in another State.

86. It was observed that in a number of States there were no provisions dealing with the power of courts to issue interim measures of protection in favour of parties to arbitration agreements; the result was that in some States courts were not willing to issue such interim measures while in other States it was uncertain whether and under what circumstances such court assistance was available. It was said that, if the Working Group decided to prepare uniform provisions on that topic, the ILA Principles on Provisional and Protective Measures in International Litigation (reproduced in paragraph 108 of document A.CN.9/WG.II/WP.108), as well as the preparatory work that led to those Principles would be useful in considering the content of the proposed uniform rules.

87. The Working Group took note of the proposal and decided to consider it at a future session.

E. Requirement of written form for arbitration agreement

(A/CN.9/WG.II/WP.108/Add.1, paras. 1-40)

88. It was generally observed that there was a need for provisions which conformed to current practice in international trade with regard to requirements for written form. It was noted that the practice in some respects was no longer reflected by the position set forth in article II(2) of the 1958 New York Convention (and other international legislative texts modelled on that article) if interpreted narrowly. It was also noted that national courts increasingly adopted a liberal interpretation of those provisions in accordance with international practice and the expectations of parties in international trade; nevertheless, it was observed, some doubts remained or views differed as to their proper interpretation. The existence of those doubts and a lack of uniformity of interpretation was a problem in international trade in that it reduced the predictability and certainty of international contractual commitments. It was further noted that current arbitration practice was different from what it was in 1958 in that arbitration was now widely accepted for resolution of international commercial disputes and could be regarded as usual rather than as an exception that required careful consideration by the parties before choosing something other than litigation before the courts.

89. It was observed that in many countries the arbitration agreement was required to be in writing to serve certain functions which included: providing evidence as to the conclusion of the agreement; enabling the parties to that agreement to be identified; and providing a warning as to the importance of renouncing rights of recourse to the courts. The view was expressed that, given the importance

of those functions, the requirement for a strict interpretation of what constituted a writing should be preserved. In reply, it was suggested that, because the development of arbitration practice between 1958 and the current time made arbitration the preferred or the usual method for international commercial dispute resolution, the warning function was no longer as important as formerly.

90. It was also observed that a number of countries had no requirement for arbitration agreements to be concluded in writing in order to be valid, a situation which did not create problems with respect to proving an arbitration agreement since evidence of the existence of an agreement could be produced in any way that would suffice to prove the existence of a contract under general law. In order to accommodate not only those current developments in arbitration practice, but also likely future developments, the view was expressed that it might be appropriate to consider removing the writing requirement and aligning the practice with respect to arbitration agreements with that of contracts more generally. Another suggestion was that it might be possible to focus on the circumstances in which an agreement might be considered to have been concluded. Those circumstances could include where there was an agreement in writing; where an agreement was evidenced by any other means as set forth in article 6 of the UNCITRAL Model Law on Electronic Commerce; where the agreement was concluded in accordance with usage recognized by the parties; or where the agreement was concluded in accordance with a usage of which the parties were aware or should have been aware because it pertained to the particular trade in which the parties were engaged.

91. As to the way in which an updated and uniform interpretation of the writing requirement could be achieved, a number of suggestions were made. One approach was to develop a model legislative provision, based upon article 7 of the UNCITRAL Model Law on International Commercial Arbitration, to clarify for the avoidance of doubt the interpretation of the requirement for writing since that provision represented a widely accepted international standard on which considerable practice had developed. Suggestions were made that the model legislative provision might possibly follow a more general approach such as the one in article 178(1) of the Swiss Federal Act of Private International Law, in article 1021 of the Arbitration Act of the Netherlands, or the somewhat more detailed approach in section 1031 of the German Arbitration Law of 1997 or section 5 of the English Arbitration Act of 1996 (those national legislative provisions are reproduced in paras. 29-31 of document A/CN.9/WG.II/WP.108/Add.1). Another suggestion, which addressed the issue in terms of the impact of electronic commerce, was to promote the adoption of the UNCITRAL Model Law on Electronic Commerce, which would have the advantage of addressing the writing issue at a broader level than that related simply to arbitration agreements (for the discussion of this topic, see below, paras. 100-106). An alternative view was that no new provisions were needed, as article 7 of the UNCITRAL Model Law on International Commercial Arbitration itself was sufficient for the purpose of providing an updated standard. Promoting wider adoption and uniform interpretation of the Model Law would lead, in time, to the required level of international uniformity.

92. Noting that there was a need for article II(2) of the New York Convention to be interpreted in accordance with a desired updated standard as to the form requirement, the Working Group discussed the question of how that objective could best be achieved. A number of different views were expressed on the issue. One view was that a protocol amending the terms of article II of the New York Convention was required. Another view was that amending the New York Convention in that way was a course of action likely to exacerbate the existing lack of harmony. It was observed that the Convention was widely adopted and extremely successful; that discussing changes to the writing requirement of the Convention could lead to suggestions for changes to other provisions which should not be reopened; and that adoption of a protocol by a number of countries was likely to take a significant number of years and, in the interim, to create more uncertainty as two different regimes would potentially apply.

93. An alternative suggestion was for the adoption of a declaration, resolution or statement addressing the interpretation of the Convention and providing that, for the avoidance of doubt, article II(2) of the Convention was intended to cover certain situations or to have a certain effect. It was observed that although that instrument would not be formally adopted as a treaty by States members of the Convention, it would potentially have persuasive force and could be considered as material assisting with the interpretation of the Convention within the terms of the Vienna Convention on the Law of Treaties. It was noted that a similar approach had been adopted in relation to other conventions, such as the Convention on the Law applicable to Contractual Obligations (Rome, 1980) and the Convention on the Law applicable to International Sales of Goods (The Hague, 1955). As to the body to adopt such a statement or declaration, it was suggested that UNCITRAL, the core legal body in the United Nations system for the development of international trade law and a body whose work in the area of arbitration had gained universal recognition, was the appropriate body to take such an action. Alternatively, States members of the New York Convention might take that action. Concerns were expressed that that approach might create uncertainty as to the status of those States not accepting the instrument and as to the possible application of reciprocity between States. It was also suggested that a declaration or recommendation was not binding on national courts and there was therefore no certainty that it would be universally followed, even if promoted by UNCITRAL.

94. As a further alternative, it was suggested that a liberal interpretation of the New York Convention should be encouraged by following the approach of some courts as noted in document A/CN.9/WG.II/WP.108/Add.1 at footnote 9, according to which the writing requirement in the New York Convention should be interpreted in the light of the subsequent UNCITRAL Model Law, whose authors wished to adapt the regime of the Convention to current needs without modifying the Convention. Another possibility suggested was to prepare practice guidelines or notes which could set out the use of article 7 of the Model Law as an interpretation tool to clarify the application of article II(2), along the lines discussed in paragraphs 33 and 34 of document A/CN.9/WG.II/WP.108/Add.1.

95. The Working Group exchanged views as to whether the cases listed at paragraph 12 of document A/CN.9/WG.II/WP.108/Add.1 would be covered by national law provisions addressing form requirements for the arbitration agreements, particularly in States that had not enacted the Model Law. A number of different views were expressed and it was clear that there was no common position for all States. It was also noted that the answer might differ if the question related to enforcement of a domestic award or a foreign award, where the terms of the New York Convention would be relevant. Cases *(a)* to *(h)*, which related to issues of writing and exchange, and thus to the manifestation of the will of the parties, were said to be distinguishable from cases *(i)* to *(l)*, which were considered to relate to matters outside the form requirement and were covered by the law governing the way in which rights and obligations that were validly assumed by a party (including those arising from an arbitration agreement) were transferred from that party to third parties or were extended to include third parties. The discussion showed that in some States cases *(a)* to *(h)* would generally be covered by the requirements of national law relating to the form of arbitration agreements, while in others it was said that certain cases would not be covered or that it was doubtful whether they were covered. Cases *(a)* and *(d)*, for example, were not covered in some States with a more restrictive interpretation of the writing requirement. In some cases, the question of coverage depended upon what was intended by the parties and no clear general answer could be given. Case *(c)* was said to be covered in some cases if the broker was deemed to represent both parties to the agreement, but was not covered if it was not representing both parties. As to bills of lading (which were typically signed by the master of the ship only), it was said that they were generally regarded by the participants in the shipping industry as evidence of valid and binding agreements to arbitrate or that, despite certain doubts, they were regarded as valid as cases sui generis. It was suggested that cases *(i)* to *(l)*, which raised issues of assignment, subrogation, incorporation by reference and third party rights, should not be addressed by the Working Group. Case *(m)* was widely considered to raise difficult issues and had not gained wide acceptance.

96. The Working Group also considered whether article II(2) of the New York Convention could be interpreted to cover all of the cases listed in paragraph 12. As in the case of national law provisions, the views expressed in the Working Group differed as to the various cases and whether or not the Convention would be interpreted to cover all of them. It was noted that the views were somewhat tentative because the cases considered were described too generally to allow definitive answers; nevertheless, the discussion showed that it was either doubtful or that there was no general agreement as to whether or not article II(2) of the New York Convention should be interpreted to cover all of the cases in paragraph 12. In addition, it was not clear how frequently the issues set forth in paragraph 12 arose in practice and how urgent they might therefore be considered to be.

97. The Working Group heard statements showing that there existed in court practice a trend towards a more liberal and updating interpretation of article II(2) of the Convention. One example that was discussed was that of England where the expression "The term 'agreement in writing' *shall include*" (emphasis added) in article II(2) of the Convention indicated that the list of forms mentioned therein was not exhaustive and could be extended to cover a wider variety of circumstances. Such an interpretation would mean, it was suggested, that most of the cases set forth in paragraph 12 would be covered by the Convention. The scope of the provision, however, was not unlimited. As a minimum form requirement, the English Arbitration Act 1996 did contain a requirement for some writing in connection with the arbitration agreement—the terms of the arbitration agreement must be set out in writing even if the party expressed consent to those terms in some way other than by writing such as by oral agreement or by part performance of the contract. The view was expressed that what the Working Group should consider was not whether the cases set out in paragraph 12 were covered by the Convention or not, but whether article II(2) could be regarded as an exhaustive provision and, if not, what the minimum form requirement for an arbitration agreement to be covered by the Convention should be. A different view of article II(2) was that it provided a uniform rule on the types of situations which were intended to be covered by the Convention and that (while requirements more restrictive than the ones specified in article II(2) were not permitted by the Convention) less restrictive requirements than the ones in article II(2) were not covered by the Convention. On that view, not all of the cases in paragraph 12 would be covered by article II(2). It was noted at the end of the discussion that the question of whether article II(2) established a uniform rule or a minimum standard remained controversial.

98. After discussion, no agreement was reached as to whether article II(2) of the New York Convention would be interpreted to cover the particular cases set forth in paragraph 12. However, the Working Group considered the question of whether those cases should be covered by the writing requirement and how that could be achieved. There was general support for the view that contract practices and the role of international commercial arbitration in international trade required that in principle all cases mentioned in paragraph 12 (with the possible exception of the case of "group of companies" mentioned under *(m)*) should be included as meeting the written form requirement, provided that there was an agreement in substance between the parties (or that a party subsequently became bound by an arbitration agreement), together with written evidence of that agreement, which, however, did not amount to requiring a document signed by both parties or an exchange of messages between the parties. It was felt that that approach would comply with two considerations underlying the form requirement for the arbitration agreement: *(a)* that there was sufficient evidence of the mutual will to arbitrate and thus to exclude court jurisdiction and *(b)* that there was some writing with respect to arbitration and thus the parties were on notice (or were warned) that they were excluding court jurisdiction. In that connection an observation was made that the purpose of parties when they agreed to arbitration was to avoid all courts and that in most multinational cases it would be difficult to determine which was the court whose jurisdiction was being excluded; therefore, it was said, the warning function in international trade, in light of the growing importance of arbitration, was losing its importance.

99. After discussion, the view was adopted by the Working Group that the objective of ensuring a uniform interpretation of the form requirement that responded to the needs of international trade could be achieved by: preparing a model legislative provision clarifying, for avoidance of doubt, the scope of article 7(2) of the UNCITRAL Model Law on International Commercial Arbitration; preparing a guide explaining the background and purpose of the model legislative provision; and adopting a declaration, resolution or statement addressing the interpretation of the New York Convention that would reflect a broad understanding of the form requirement. As to the substance of the model legislative provision and the interpretative instrument to be prepared, the Working Group adopted the view that, for a valid arbitration agreement to be concluded, it had to be established that an agreement to arbitrate had been reached and that there existed some written evidence of that agreement. It was noted that the issue of how best to achieve uniform interpretation of the New York Convention through a declaration, resolution or statement should be further studied, including the public international law implications, to determine which was the optimal approach.

F. Arbitration agreement "in writing" and electronic commerce

(A/CN.9/WG.II/WP.108/Add.1, paras. 35-40)

100. The Working Group considered the question of whether article II(2) of the New York Convention should be interpreted broadly to include communications by electronic means as defined by the UNCITRAL Model Law on Electronic Commerce in article 2. It was recalled that the Guide to Enactment to the Model Law, an instrument adopted by the Commission, was drafted with a view to clarifying the relationship between the Model Law on Electronic Commerce and international instruments such as the New York Convention and other trade law instruments. The Guide, at paragraph 6, suggested that the Model Law on Electronic Commerce "may be useful in certain cases as a tool for interpreting existing international conventions and other international instruments that create legal obstacles to the use of electronic commerce for example by prescribing that certain documents or contractual clauses be made in written form". It was also noted that article 7(2) of the Model Law on International Commercial Arbitration expressly validated the use of any means of telecommunication "which provides a record of the agreement", a wording which would cover telecopy or facsimile messages as well as most common uses of electronic mail or electronic data interchange (EDI) messaging.

101. There was general agreement in the Working Group that, in order to promote the use of electronic commerce for international trade and leave the parties free to agree to the use of arbitration in the electronic commerce sphere, article II(2) of the New York Convention should be interpreted to cover the use of electronic means of communication as defined in article 2 of the Model Law on Electronic Commerce and that it required no amendment to do that. It was also considered that, in addition to the New York Convention, other conventions relevant to international arbitration such as the European Convention on International Commercial Arbitration (Geneva, 1961) and the Inter-American Convention on International Commercial Arbitration (Panama, 1975), should also be interpreted in the same way. As doubts were raised as to whether UNCITRAL was the appropriate forum to address that issue in respect of all of those conventions, it was agreed that the issue should be studied and the optimal solution found in consultation with the organizations that sponsored the preparation of those conventions.

102. On the question of how the desired updating interpretation could be achieved, the Working Group made a number of proposals. One proposal was that the Model Law on Electronic Commerce could be used as an interpretive instrument as noted in the Guide to Enactment. Concern was expressed that that approach might have limited effect. While the Model Law was being applied in an increasing number of countries, it was not universally adopted. Furthermore it was noted that, because of the flexibility of the model law form, the Model Law might be enacted in different ways and that, therefore, the desired uniform interpretation would not be achieved.

103. A second proposal was for a declaration confirming the desired interpretation to be adopted by UNCITRAL or perhaps by the States members of the conventions. In support of the use of a declaration, it was recalled that the Working Group had already considered and identified that form of instrument as a potentially useful way of addressing the interpretation of the writing requirement in article II(2) (see above, para. 93). It was proposed that the same measure should apply to electronic communications, although questions were raised as to whether the two declarations should be linked together. For the same reasons as discussed in the context of the writing requirement, it was suggested that any such declaration should be drafted on the basis that the UNCITRAL Model Law on Electronic Commerce can be used, by itself, as a tool to interpret the conventions and that therefore the declaration should be framed in terms of "For the avoidance of doubt …" (see above, para. 91).

104. A third proposal was to seek a solution in the context of a broader idea (which had been raised and discussed by the Commission at its thirty-second session (A/54/17, para. 316)) of preparing an "omnibus" protocol to amend multilateral treaty regimes to facilitate the increased use of electronic commerce, as noted in paragraph 39 of document A/CN.9/WG.II/WP.108/Add.1. Little support was expressed in favour of that proposal. The Working Group was of the view that more studies were needed before a decision could be made on the nature of such instrument to be adopted and the possibility of drafting a commentary was also voiced.

105. Having concluded the discussion on the desirability of ensuring that article II(2) of the New York Convention (and the relevant provisions in other conventions that followed that model) would validate electronic communications, concerns were expressed as to possible implications of limiting the proposed interpretative instrument to the requirement of writing for the arbitration agreement. It was noted that other provisions in the New York Convention (as well as in other conventions on international commercial arbitration) contained additional requirements of writing which, if not interpreted to include electronic means of

communication, might potentially operate as barriers to the facilitation of electronic commerce. Included among those were the requirements to provide originals of the arbitration agreement and the award in article IV of the New York Convention. The view was expressed that the issue of electronic commerce should be approached from a perspective broader than the writing requirement for the arbitration agreement and that, in considering steps to be taken with respect to the writing requirement for arbitration agreements, other form requirements in instruments governing international commercial arbitration should also be studied. It was also suggested that treating these issues as separate had the potential to encourage a proliferation of interpretative declarations on points that may be regarded, in the future, as requiring clarification.

106. After discussion, the Working Group requested the secretariat to prepare a draft instrument that would confirm that article II(2) of the New York Convention should be interpreted to include electronic communications as defined by article 2 of the Model Law on Electronic Commerce. In drafting that instrument, the secretariat should study the other form requirements in the New York Convention and prepare appropriate drafts to facilitate discussion in the Working Group as to the treatment of other writing requirements.

G. Possible topics for future work

(A.CN.9/WG.II/WP.108/Add.1, para. 42)

107. Having completed its discussion on the topics set forth in documents A/CN.9/WG.II/WP.108 and Add.1, the Working Group exchanged views and information on other arbitration topics that had been identified by the Commission as likely items of future work and which had been considered by the Commission at its thirty-second session. The complete list of those topics (reproduced in document A/CN.9/WG.II/WP.108, para. 6), which included the three topics considered at length at the current session of the Working Group, was as follows:

(a) Conciliation (A/CN9/460, paras. 8-19; A/54/17, paras. 340-343).

(b) Requirement of written form (A/CN.9/460, paras. 20-31; A/54/17, paras. 344-350).

(c) Arbitrability (A/CN.9/460, paras. 32-34; A/54/17, paras. 351-353).

(d) Sovereign immunity (A/CN.9/460, paras. 35-50; A/54/17, paras. 354 and 355).

(e) Consolidation of cases before arbitral tribunals (A/CN.9/460, paras. 51-60; A/54/17, paras. 356 and 357).

(f) Confidentiality of information in arbitral proceedings (A/CN.9/460, paras. 62-71; A/54/17, paras. 358 and 359).

(g) Raising claims for the purpose of set-off (A/CN.9/460, paras. 72-79; A/54/17, paras. 360 and 361).

(h) Decisions by "truncated" arbitral tribunals (A/CN.9/460, paras. 80-91; A/54/17, paras. 362 and 363).

(i) Liability of arbitrators (A/CN.9/460, paras. 92-100; A/54/17, paras. 364-366).

(j) Power by the arbitral tribunal to award interest (A/CN.9/460, paras. 101-106; A/54/17, paras. 367-369).

(k) Costs of arbitral proceedings (A/CN.9/460, paras. 107-114; A/54/17, para. 370).

(l) Enforceability of interim measures of protection (A/CN.9/460, paras. 115-127; A/54/17, paras. 371-373).

(m) Possible enforceability of an award that has been se aside in the State of origin (A/CN.9/460, paras. 128-144; A/54/17, paras. 374-376).

108. Other topics considered were those mentioned in paragraph 339 of the report of the Commission on the work of its thirty-second session (document A/54/17):

(a) Gaps in contracts left by the parties and filling of those gaps by a third person or an arbitral tribunal on the basis of an authorization of the parties.

(b) Changed circumstances after the conclusion of a contract and the possibility that the parties entrusted a third person or an arbitral tribunal with the adaptation of the contract to changed circumstances.

(c) Freedom of parties to be represented in arbitral proceedings by persons of their choice and the issue of limits to that freedom based on, for example, nationality or membership in a professional association.

(d) Questions relating to the interpretation of legislative provisions such as those in article II(3) of the New York Convention (or article 8(1) of the UNCITRAL Model Law on International Commercial Arbitration), which in practice led to divergent results, in particular the question of the court's terms of reference (i) in deciding whether to refer the parties to arbitration, (ii) in considering whether the arbitration agreement was null and void, inoperative or incapable of being performed, and (iii) where the defendant invoked the fact that an arbitration proceeding was pending or that an arbitral award had been issued; and

(e) Questions relating to cases where a foreign court judgement was presented with a request for its recognition or enforcement, but where the respondent, by way of defence, invoked (i) the existence of an arbitration agreement, or (ii) the fact that an arbitration proceeding was pending, or (iii) the fact that an arbitral award had been issued in the same matter. It was noted that those instances were often not addressed by treaties dealing with recognition and enforcement of foreign court judgements. Difficulties arose in particular where the applicable treaty was designed to facilitate recognition and enforcement of court judgements, but the treaty itself did not allow recognition or enforcement to be refused on the ground that the dispute dealt with by the judgement was covered by an arbitration agreement,

was being considered in a pending arbitral proceeding, or was the subject matter of an arbitral award.

109. A number of other topics concerning the New York Convention, proposed by arbitration experts, were raised for possible consideration by the Working Group. Those included:

(a) The meaning and effect of a non-domestic award, that is an award not considered as a domestic award in the State where its recognition and enforcement was sought (article I(1), second sentence).

(b) Clarification of what constituted an arbitral award under the Convention. Did it cover, for example, awards on agreed terms; "Treaty awards"; a national awards; award-like decisions in proceedings akin to arbitration, such as arbitrato irrituale.

(c) Determination of the law applicable to arbitrability under article II(1).

(d) Field of application of article II(3) concerning the enforcement of the arbitration agreement.

(e) Law applicable to agreements that might be "null and void, inoperative, or incapable of being performed" under article II(3).

(f) Compatibility of court-ordered interim measures with arbitration agreements falling under the Convention.

(g) Enforcement conditions and procedure referred to in article III, as implementing legislation showed diverging solutions.

(h) Period of limitation for enforcement of a Convention award where again implementing legislation showed a range of different periods.

(i) Residual discretionary power to grant enforcement of an award notwithstanding the existence of a ground for refusal listed in article V.

(j) Meaning and effect of the suspension of an arbitral award in the country of origin (article V(i)*(e)*); and

(k) Meaning and effect of the more-favourable-right provision of article VII(1).

110. It was noted that a number of those possible additional topics might partly touch upon or overlap with topics already discussed by or raised in the Commission, but that they were raised here as matters that might be of interest to the Working Group for possible further consideration. It was noted that items *(g)* and *(h)* (above, para. 109) were the subject of the project being jointly undertaken by UNCITRAL and Committee D of the International Bar Association to monitor the legislative implementation of the New York Convention (A/54/17, paras. 331 and 332).

111. The Working Group, by way of an initial and tentative response, expressed particular interest in a number of the items set forth in paragraphs 108 and 109 above. Support was expressed in favour of preparatory work by the secretariat of items *(a), (b), (d)* and *(e)* of paragraph 108 on the basis that they were of significant practical importance. Item *(d)*, in particular, was noted as causing uncertainty and, potentially, delay in a number of States. In respect of item *(e)*, it was noted that article II(3) of the New York Convention left doubts for some courts as to how they should proceed, which resulted in a diversity and inconsistency of approaches; for example, some courts, when they considered a request (e.g. under art. II(3) of the New York Convention) to refer the parties to arbitration, followed the spirit of the Convention and limited their consideration to whether the arbitration agreement was prima facie valid (and, if it was found to be prima facie valid, referred the issue to be determined by the arbitral tribunal), while other courts considered the validity of the arbitral agreement themselves and reached a final decision. It was noted that bringing greater clarity to those issues would better define the inter-relationship between courts and arbitral tribunals in arbitration matters. Some support was also expressed in favour of considering items *(a), (b)* and *(e)* of paragraph 109 above.

112. In terms of the items already discussed and accorded priority by the Commission, as set forth in paragraph 107 above, interest was reiterated in a number of those. With respect to item *(m)* (possible enforceability of awards that had been set aside in the State of origin), to which the Commission had accorded priority, a view was expressed that the case for its further consideration did not fully appreciate the fact that, in practice, the issue was not expected to raise many problems and that cases cited in connection with that issue should not be regarded as precedent. It was suggested, however, that (as noted above in paragraph 109*(i)*), that item involved a broader spectrum of issues, such as, the question of the discretionary power to enforce an award even where a ground for refusal existed (such as a minor procedural defect or a defect that did not influence the outcome of the arbitration). Other items in paragraph 107 in which interest was expressed in the Working Group were *(e)* consolidation of cases before arbitral tribunals; *(f)* the duty of confidentiality, with regard to both arbitration and conciliation; *(g)* jurisdiction for claims raised for the purpose of set-off; *(h)* decisions by truncated tribunals; *(j)* the power to award interest and possibly other issues relating to interest; and *(k)* costs of arbitral proceedings.

113. Recalling the discussion of increased use of electronic commerce and the question whether electronic messages complied with formal requirements for arbitration agreements and other formal requirements (see above, paras. 100-106), the Working Group took note of suggestions that it would be useful to review the implications of "on-line" arbitrations, i.e. arbitrations in which significant parts or even all of arbitral proceedings were conducted by using electronic means of communications.

114. The secretariat was requested to take into account the views expressed in the Working Group in preparing material to be considered by the Working Group at future sessions. In order to facilitate that preparatory work by the secretariat, States and interested international organizations were requested to provide material on court or arbitration cases and examples of provisions from national laws that would assist the secretariat in preparation of this material.

H. Other business

115. The Working Group was informed by representatives of the UN/ECE Advisory Group on the European Convention on International Commercial Arbitration (Geneva, 1961) of the United Nations Economic Commission for Europe of the meeting of the Advisory Group on 17 and 18 February 2000 in Vienna at which the Group concluded that the Convention *(a)* remained useful; *(b)* provided a utility beyond that of existing conventions (in particular, as a common set of minimum standards to be observed in international arbitration); and *(c)* could be made even more useful to both existing and potential new contracting States if it were updated. The Advisory Group concluded at its February meeting to modify article IV of the Convention and the Agreement relating to Application of the European Convention on International Commercial Arbitration. No consensus was reached as to whether any additional changes to the Convention should be made. The Commission appreciated the report and expressed the hope that any future work in the Economic Commission for Europe would not duplicate the work undertaken at the global level by UNCITRAL.

116. The Working Group also heard with appreciation the plans of the Economic Commission for Europe to provide, in the context of the Southeast European Cooperative Initiative (SECI), advice and assistance to foster the smooth functioning of international commercial arbitration in the States members of SECI.

A/CN.9/WG.II/WP.108

B. Working paper submitted to the Working Group on Arbitration at its thirty-second session: Settlement of Commercial Disputes: Possible uniform rules on certain issues concerning settlement of commercial disputes: conciliation, interim measures of protection, written form for arbitration agreement

(A/CN.9/465/WG.II/WP.108 and Add.1) [Original: English]

CONTENTS

[Chapter III, "Requirement of written form for arbitration agreement", will be published in doc. A/CN.9/WG.II/WP.108/Add.1]

INTRODUCTION

1. The Commission, during its thirty-first session, held a special commemorative New York Convention Day on 10 June 1998 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 Secretary-General of the United Nations made the opening speech. In addition to speeches by former participants in the diplomatic conference that adopted the Convention, leading arbitration experts gave reports on matters such as the promotion of the Convention, its enactment and application. Reports were also given on matters beyond the Convention itself, such as the interplay between the Convention and other international legal texts on international commercial arbitration and on practical difficulties that were encountered in practice but were not addressed in existing legislative or non-legislative texts on arbitration.[1]

2. In reports presented at that commemorative conference, 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.

3. The Commission, at its thirty-first session in 1998, with reference to the discussions at the New York Convention Day, considered that it would be useful to engage in a discussion of possible future work in the area of arbitration at its thirty-second session in 1999. It requested the secretariat to prepare a note that would serve as a basis for the considerations of the Commission.[2]

4. At its thirty-second session, the Commission had before it the requested note entitled "Possible future work in the area of international commercial arbitration" (document A/CN.9/460). The note drew on ideas, suggestions and considerations expressed in different contexts, such as the New York Convention Day, the Congress of the International Council for Commercial Arbitration (Paris, 3-6 May 1998),[3] and other international conferences and forums, such as the 1998 "Freshfields" lecture.[4] The note discussed some of the issues and problems identified in arbitral practice in order to facilitate a discussion in the Commission as to whether it wished to put any of those issues on its work programme.

5. The Commission welcomed the note by the secretariat and the opportunity to discuss the desirability and feasibility of further development of the law of international commercial arbitration. It was generally considered that the time had arrived to assess the extensive and favourable experience with national enactments of the UNCITRAL Model Law on International Commercial Arbitration (1985) as well as the use of the UNCITRAL Arbitration Rules and the UNCITRAL Conciliation Rules, and to evaluate in the universal forum of the Commission the acceptability of ideas and proposals for improvement of arbitration laws, rules and practices.

6. Possible work topics considered by the Commission were the following:

(a) Conciliation (A/CN9/460, paras. 8-19; A/54/17, paras. 340-343).

(b) Requirement of written form (A/CN.9/460, paras. 20-31; A/54/17, paras. 344-350).

(c) Arbitrability (A/CN.9/460, paras. 32-34; A/54/17, paras. 351-353).

(d) Sovereign immunity (A/CN.9/460, paras. 35-50; A/54/17, paras. 354 and 355).

(e) Consolidation of cases before arbitral tribunals (A/CN.9/460, paras. 51-60; A/54/17, paras. 356 and 357).

(f) Confidentiality of information in arbitral proceedings (A/CN.9/460, paras. 62-71; A/54/17, paras. 358 and 359).

(g) Raising claims for the purpose of set-off (A/CN.9/460, paras. 72-79; A/54/17, paras. 360 and 361).

(h) Decisions by "truncated" arbitral tribunals (A/CN.9/460, paras. 80-91; A/54/17, paras. 362 and 363).

(i) Liability of arbitrators (A/CN.9/460, paras. 92-100; A/54/17, paras. 364-366).

(j) Power by the arbitral tribunal to award interest (A/CN.9/460, paras. 101-106; A/54/17, paras. 367-369).

(k) Costs of arbitral proceedings (A/CN.9/460, paras. 107-114; A/54/17, para. 370).

(l) Enforceability of interim measures of protection (A/CN.9/460, paras. 115-127; A/54/17, paras. 371-373).

(m) Possible enforceability of an award that has been set aside in the State of origin (A/CN.9/460, paras. 128-144; A/54/17, paras. 374-376).

7. At various stages of the discussion, several other topics, in addition to those contained in document A/CN.9/460, were mentioned as potentially worthy of being taken up by the Commission at an appropriate future time (A/54/17, para. 339).

8. In its considerations the Commission kept an open mind as to the ultimate form that future work of the Commission might take. It was agreed that decisions as to the form should be taken later as the substance of proposed solutions became clearer. Uniform provisions might, for example, take the form of a legislative text (such as model legislative provisions or a treaty) or a non-legislative text

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[1] *Enforcing Arbitration Awards under the New York Convention: Experience and Prospects* (United Nations publication, Sales No. E.99.V.2).

[2] *Official Records of the General Assembly, Fifty-third Session, Supplement No. 17* (A/53/17), para. 235.

[3] *Improving the Efficiency of Arbitration Agreements and Awards: 40 Years of Application of the New York Convention, International Council for Commercial Arbitration Congress Series No. 9,* Kluwer Law International, 1999.

[4] Gerold Herrmann, "Does the world need additional uniform legislation on arbitration?" *Arbitration International,* vol. 15 (1999), No. 3, page 211.

(such as a model contractual rule or a practice guide). It was stressed that, even if an international treaty were to be considered, it was not intended to be a modification of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). It was thought that, even if ultimately no new uniform text would be prepared, an in-depth discussion by delegates from all major legal, social and economic systems represented in the Commission, possibly with suggestions for uniform interpretation, would be a useful contribution to the practice of international commercial arbitration. The considerations of the Commission on those issues are reflected in document A/54/17 (paras. 337-376 and para. 380).

9. After concluding the discussion on its future work in the area of international commercial arbitration, it was agreed that the priority items for the working group should be conciliation (A/54/17, paras. 340-343), requirement of written form for the arbitration agreement (A/54/17, paras. 344-350), enforceability of interim measures of protection (A/54/17, paras. 371-373) and possible enforceability of an award that had been set aside in the State of origin (A/54/17, paras. 374 and 375). It was expected that the secretariat would prepare the necessary documentation for the first session of the Working Group for at least two, and possibly three, of those four topics. As to the other topics discussed in document A/CN.9/460, as well as topics for possible future work suggested at the thirty-second session of the Commission (A/54/17, para. 339), which were accorded lower priority, the Working Group was to decide on the time and manner of dealing with them.

10. The Commission entrusted the work to a working group to be named "Working Group on Arbitration", authorized it to meet from 20 to 31 March 2000 and requested the secretariat to prepare the necessary documentation for the meeting. The present document has been prepared pursuant to that request.

I. CONCILIATION

A. General remarks

11. The term "conciliation" is used here as a broad notion referring to proceedings in which a person or a panel of persons assists the parties in an independent and impartial manner in their attempt to reach an amicable settlement of their dispute. Conciliation differs from negotiations between the parties in dispute (in which the parties would typically engage after the dispute has arisen) in that conciliation involves independent and impartial assistance to settle the dispute, whereas in settlement negotiations between the parties no such third-person assistance is involved. The difference between conciliation and arbitration is that a conciliation ends either in a settlement of the dispute agreed by the parties or it ends unsuccessfully; in arbitration, however, the arbitral tribunal imposes a binding decision on the parties, unless the parties have settled the dispute before the award is made.

12. Conciliation proceedings in the above sense are envisaged and dealt with in a number of rules of arbitral institutions and institutions specializing in the administration of various forms of alternative methods of dispute resolution, as well as in the UNCITRAL Conciliation Rules, which the Commission adopted in 1980. These Rules are widely used and have served as a model for rules of many institutions.

13. Conciliation proceedings in which parties in dispute agree to be assisted in their attempt to reach a settlement may differ in procedural details depending on what is considered the best method to foster a settlement between the parties. Nevertheless, such proceedings, as considered in this paper, are characterized by independent and impartial assistance in reaching an amicable settlement of a dispute and the fact that no binding decision will be made if the parties are unable to settle the dispute.

14. In practice, such conciliation may be referred to by other expressions, among which "mediation" or terms of similar meaning are frequently used. The notion of "alternative dispute resolution" is also used to refer collectively to various techniques and adaptations of procedures for solving disputes by conciliatory methods rather than by a binding method such as arbitration. This paper uses the term "conciliation" as synonymous to all those procedures. To the extent that such "alternative dispute resolution" procedures are characterized by features mentioned above, they are covered by this paper.

15. Conciliation is being increasingly practised in various parts of the world, including regions where until a decade or two ago it was not commonly used. This trend is reflected, for example, in the establishment of a number of private and public bodies offering services to interested parties designed to foster the amicable settlement of disputes. This trend, and a growing desire in various regions of the world to promote conciliation as a method of dispute settlement, has given rise to discussions calling for internationally harmonized legal solutions designed to facilitate conciliation.

B. Consideration in the Commission

16. When the Commission discussed its possible future work in the area of conciliation (A/54/14, para. 340), there was general agreement that the following three issues were particularly important: admissibility of certain evidence in subsequent judicial or arbitral proceedings; role of the conciliator in subsequent arbitration or court proceedings; and procedures for enforcing settlement agreements. It was widely felt that, in addition to those three issues, the possible interruption of limitation periods as a result of the commencement of conciliation proceedings was worthy of consideration.

17. The prevailing view that emerged in the Commission was that it would be worthwhile to explore the possibility of preparing uniform legislative rules to support the increased use of conciliation (A/54/17, para. 342). It was noted that, while certain issues (such as the admissibility of certain evidence in subsequent judicial or arbitral proceedings, or the role of the conciliator in subsequent proceedings) could typically be solved by reference to sets of rules

such as the UNCITRAL Conciliation Rules, there were many cases where no such rules were agreed upon. The conciliation process might thus benefit from the establishment of non-mandatory legislative provisions that would apply when the parties mutually desired to conciliate but had not agreed on a set of conciliation rules. Moreover, in countries where agreements as to the admissibility of certain kinds of evidence were of uncertain effect, uniform legislation might provide a useful clarification. In addition, it was pointed out with respect to issues such as facilitating the enforcement of settlement agreements resulting from conciliation and the effect of conciliation with respect to the interruption of a limitation period, that the level of predictability and certainty required to foster conciliation could only be achieved through legislation.

C. Possible questions on which uniform provisions may be prepared

1. Admissibility of certain evidence in subsequent judicial or arbitral proceedings

18. In conciliation proceedings, the parties typically express suggestions and views regarding proposals for a possible settlement, make admissions or indicate their willingness to settle. If despite such efforts the conciliation does not result in a settlement and a party initiates judicial or arbitral proceedings, those views, suggestions, admissions or indications of willingness to settle might be used to the detriment of the party who made them. This possibility of "spillover" of certain facts that occurred during conciliation may discourage parties from actively trying to reach a settlement during conciliation proceedings, which may greatly reduce the usefulness of conciliation.

19. In order to address the above problem, article 20 of UNCITRAL Conciliation Rules provides:

> "The parties undertake not to rely on or introduce as evidence in arbitral or judicial proceedings, whether or not such proceedings relate to the dispute that is the subject of the conciliation proceedings:
>
> "*(a)* Views expressed or suggestions made by the other party in respect of a possible settlement of the dispute;
>
> "*(b)* Admissions made by the other party in the course of the conciliation proceedings;
>
> "*(c)* Proposals made by the conciliator;
>
> "*(d)* The fact that the other party had indicated his willingness to accept a proposal for settlement made by the conciliator."

20. If the parties use no conciliation rules or use rules that do not contain a provision such as article 20 of the UNCITRAL Conciliation Rules, under many legal systems the parties may be affected by the described problem. Even if the parties have agreed on a rule such as the one contained in article 20, it may not be certain that the agreement concerning evidence will be given full effect by the court. In order to assist the parties in such situations, some jurisdictions have adopted laws designed to prevent the introduction of certain evidence relating to previous conciliation proceedings into subsequent judicial or arbitral proceedings. Some of those laws are modelled on article 20 of the UNCITRAL Conciliation Rules.

21. The Working Group may wish to consider whether it would be useful to prepare a uniform provision on this matter and which approach should be followed in drafting the provision.

22. One possible approach may be for the law to give express recognition to an agreement of the parties such as the one contained in the above-cited article 20 of the UNCITRAL Conciliation Rules. This solution would be designed to eliminate any uncertainty as to whether the parties may agree not to use as evidence in arbitral or judicial proceedings certain facts that occurred during the conciliation. The solution would also leave it to the parties to tailor the extent to which those facts may be used as evidence outside the conciliation. However, a consequence of this approach would be that, if the parties participate in conciliation proceedings without having agreed on a rule of evidence such as in article 20 of the UNCITRAL Rules, the consideration of views, suggestions, admissions made during conciliation proceedings in subsequent adversary proceedings may not be prevented.

23. Another approach may be taken if it is considered that certain circumstances in conciliation proceedings should not be relied upon as evidence in court or arbitral proceedings even if the parties have failed to agree on a rule such as article 20 of the UNCITRAL Rules. Two possible solutions may be envisaged: *(a)* under one, the law would provide that evidence of facts such as those mentioned in article 20 of the UNCITRAL Rules are not to be admitted in evidence and that disclosure of those facts is not to be ordered by the arbitral tribunal or the court; *(b)* under another solution, it may be provided that it is an implied term of an agreement to conciliate that the parties undertake not to rely as evidence in any arbitral or judicial proceedings on facts such as those mentioned in article 20 of the UNCITRAL Rules.

24. There may be little practical difference in the enacting State between the straightforward evidentiary rule under *(a)* and the "implied agreement" rule under *(b)*. However, there may be a difference between them in a foreign State where the subsequent court or arbitral proceedings are taking place. A provision such as the one under *(a)* that has been enacted in State A may not be heeded in State B, whereas, if an agreement to conciliate is to imply an evidentiary undertaking of the parties, such undertaking might be recognized in State B.

25. Whichever approach is chosen, the Working Group may also wish to consider whether it would be useful to clarify that there should be no limitation to the admissibility of evidence if all parties participating in the conciliation later consent to its disclosure.

26. It may also be considered whether it should be provided that, in the event that any evidence is offered in contravention of the statutory provision, the arbitral tribunal or the court is to make any order it considers to be appropriate to deal with the matter. Such order may be, for

instance, an order restricting the introduction of evidence, or an order dismissing the case on procedural grounds without prejudice for the substance of the case.

27. Some laws contain a provision, in addition to the provision modelled on article 20 of the UNCITRAL Rules, dealing with documents prepared for the purpose of, or in the course of, or pursuant to, the conciliation. They provide that no such documents are admissible in evidence, and disclosure of such documents should not be compelled in any arbitration or civil action. The Working Group may wish to consider what would be the practical consequences of such a provision in view of the fact that a provision that prevents raising the facts mentioned in article 20 of the UNCITRAL Rules would largely have the same effect as a provision barring the use as evidence of documents prepared for the purpose of, or in the course of, or pursuant to, the conciliation.

28. In some legal systems a party may not be compelled to produce in court proceedings a document that enjoys a "privilege", such as, for example, a written communication between a client and its attorney. However, such privilege may be deemed lost if a party has relied on the privileged document in a proceeding. As privileged documents may be presented in conciliation proceedings with a view to facilitating settlement, and in order not to discourage the use of privileged documents in conciliation, the Working Group may wish to consider whether it would be useful to prepare a uniform provision stating that the use of a privileged document in conciliation proceedings does not constitute a waiver of the privilege.

2. Role of conciliator in arbitration or court proceedings

29. A party may be reluctant to strive actively for a settlement in conciliation proceedings if it has to take into account the possibility that, if the conciliation is not successful, the conciliator might be appointed as a representative (or counsel) of the other party or as an arbitrator in subsequent arbitration or court proceedings. The party may be similarly reluctant if the conciliator may be presented as a witness in such subsequent proceedings. The conciliator's knowledge of certain facts occurring during conciliation (e.g. proposals for settlement and admissions) might prove to be prejudicial for one of the parties if the conciliator would use or express that knowledge in the subsequent proceedings. This is the reason behind the provision of article 19 of the UNCITRAL Conciliation Rules, which reads as follows:

> "The parties and the conciliator undertake that the conciliator will not act as an arbitrator or as a representative or counsel of a party in any arbitral or judicial proceedings in respect of a dispute that is the subject of the conciliation proceedings. The parties also undertake that they will not present the conciliator as a witness in any such proceedings."

30. However, in some cases, prior knowledge on the part of the arbitrator might be regarded by the parties as advantageous, in particular if it is thought that that knowledge will allow the arbitrator to conduct the case more efficiently. In such cases, the parties may actually prefer that the conciliator and not somebody else be appointed as an arbitrator in the subsequent arbitral proceedings. The rule in article 19 of the Conciliation Rules poses no obstacle to such appointment of the former conciliator provided the parties depart from the rule by agreement. A joint appointment of the conciliator to serve as an arbitrator would constitute such an agreement.

31. Considerations such as those summarized in the preceding paragraph have led some jurisdictions to adopt legislative provisions modelled on article 19 with the provision that the provision is not mandatory.

32. The Working Group may wish to consider whether it would be useful to prepare a uniform legislative provision on this matter. If so, one question to be considered is whether the provision should state that the parties and the conciliator are deemed to have undertaken that the conciliator will not be involved in any arbitral or judicial proceedings (as an arbitrator, representative, counsel or witness), or whether the provision should set out a straightforward prohibition for the conciliator to be involved in such subsequent proceedings. In either case, the Working Group may wish to provide that the parties' agreement may override the deemed undertaking or the prohibition. As to the restriction regarding admissibility of the conciliator's testimony in court or arbitral proceedings, the Working Group may wish to discuss whether the restriction needs to be qualified. For example, it may be considered that the conciliator may be called to give testimony about facts mentioned in article 20 of the UNCITRAL Conciliation Rules in order to prove other circumstances (e.g. fraud).

33. Another question that may be discussed is whether the provision is to be limited to the arbitrator's participation "in respect of a dispute that is the subject of the conciliation proceedings". Namely, in the case of contracts that are distinct but commercially and factually closely related, a conciliator may be restricted from participating in arbitration or court proceedings concerning one contract but would not be so prevented regarding other related contracts, with respect to which the same or similar reservations as to the conciliator's participation may apply. Extending such a restriction to a group of contracts raises questions such as how to define the connection between contracts and whether the benefits from the provision would justify the potentially far-reaching restrictions resulting from it.

3. Enforceability of settlement agreements

34. Many practitioners have put forward the view that the attractiveness of conciliation would be greatly increased if a settlement reached during a conciliation would, for the purposes of enforcement, be treated as or similarly to an arbitral award. By subjecting conciliation settlements to the enforcement rules governing arbitral awards, the enforcement of these settlements would be simplified and expedited. Typically this would mean that conciliation settlements would be enforced by the court without reopening

factual or substantive legal questions (except for the possible question of public policy).

35. In assessing the benefits of giving the quality of an enforceable title to a settlement reached in conciliation proceedings, the question may be asked whether it is worthwhile to confer that quality on conciliation settlements in view of the fact any settlement, whether or not it is concluded during conciliation proceedings, is binding and enforceable as a contract. Admittedly, it is usually relatively easy to obtain a court judgement or an arbitral award on the basis of an agreed settlement (in any case easier as compared to the case where the parties in dispute have not concluded a settlement). Nevertheless, the prospect of having to spend time and money on court proceedings or an arbitration in order to enforce a settlement reduces the attractiveness of conciliation. In line with this reasoning, proposals have been advanced, and legislation adopted in some States, that seek to facilitate enforcement of settlements reached in conciliation.

36. A possible way of obtaining an enforceable title and avoiding initiation of adversary proceedings would be for the parties who have reached a settlement to appoint the conciliator as an arbitrator and limit the arbitration proceedings to recording the settlement in the form of an arbitral award on agreed terms (as provided for, e.g. in art. 34(1) of the UNCITRAL Arbitration Rules). A possible obstacle to this approach, however, may arise in a number of legal systems in which, once a settlement has been reached and the dispute has thereby been eliminated, it is not possible to institute arbitral proceedings. In order to avoid this obstacle, legislation might expressly permit the parties to the settlement, despite the disappearance of the dispute, to commence arbitration with a view to requesting the arbitrator (who may be the former conciliator) to record the settlement in the form of an arbitral award on agreed terms.

37. In order to provide a straightforward solution, and thereby avoid the need for instituting arbitral proceedings that would convert a settlement into an award on agreed terms, some laws have provided that the settlement agreement reached in conciliation proceedings is to be enforceable as an arbitral award. For example, according to one law, the settlement agreement is to be treated, for the purposes of its enforcement in that State, as an arbitral award pursuant to an arbitration agreement and may be enforced as such; another law provides that the written settlement agreement is to have the same status and effect as if it were an arbitral award on agreed terms on the substance of the dispute rendered by an arbitral tribunal.

38. The question that arises with respect to a legislative provision which subjects conciliation settlements to the enforcement rules applicable to arbitral awards is how to distinguish settlements that should receive this special status from settlements (which may or may not have been reached with the assistance of a third person) which should not enjoy such a special status.

39. Laws that contain a legislative provision subjecting conciliation settlements to the enforcement provisions governing arbitral awards do not provide a discrete and express definition or distinction of such conciliation settlements. An answer may be deduced, however, from the following: the law contains procedures for conciliation and requires that the conciliator be an independent and impartial person, with the result that only those settlements that are concluded pursuant to the procedures set out in the law would be enforceable as an award. One law adds a requirement that the conciliator "authenticate the settlement agreement and furnish a copy thereof to each party". Other laws provide that if "the result of the conciliation is in writing and signed by the conciliator or conciliators and the parties or their representatives, the written agreement shall be treated as an arbitral award". Another law states that "if the parties to an arbitration agreement" reach agreement by means of conciliation or otherwise in settlement of their dispute and enter into an agreement in writing containing the terms of settlement, that settlement agreement is to be treated as an award. It may be concluded from such a provision that only settlement agreements reached between parties that have concluded an arbitration agreement enjoy the special status of enforceability as long as the dispute is covered by the arbitration agreement. Finally, provisions on enforceability of settlements reached in conciliation are found in legislation on commercial arbitration, with the implication that only conciliation settlements in commercial matters are enforceable as awards.

40. There might be additional features that could be considered as possible distinguishing elements for settlements that should be enforceable like arbitral awards. One may be that the settlement agreement signed by the parties and the conciliator should contain an "enforceability clause"; the advantage of such a requirement would be that the parties would be alerted to the fact that, by signing the settlement, they are opting for an enforcement procedure different from the procedures generally applicable to the enforcement of contracts.

41. As noted above, "conciliation proceedings" cover different types of proceedings, including those referred to as "mediation". Therefore, it seems that, whichever the definition of enforceable settlements, it is desirable to make sure that the definition is broad enough to cover any proceedings, whether or not designated as "conciliation", as long as the proceedings are characterized by the required features. In considering such a definition, article 7 of the UNCITRAL Conciliation Rules (reproduced below in para. 61) may serve as an inspiration. Furthermore, the Working Group may wish to bear in mind that, depending on the decisions to be taken on other issues on conciliation outlined below, the way in which conciliation is defined may be important for questions of application.

42. An additional, and practically important, question that the Working Group may wish to discuss is whether settlement agreements declared by law as enforceable in one country should enjoy the same or similar status in other countries. If such international effects of enforceability are contemplated, a treaty might seem as a traditional vehicle for achieving the objective. While certainty of a treaty may appear as an advantage, its disadvantage lies, for instance, in the difficulty of its adoption by a sufficient number of countries within a foreseeable period of time. Therefore, the Working Group may wish to consider model legislative

provisions as an appropriate vehicle for harmonization, in the same manner as articles 35 and 36 of the UNCITRAL Model Law on International Commercial Arbitration have been used for regulating the enforcement of domestic and foreign arbitral awards.

4. Other possible items for harmonized treatment

43. In addition to discussing possible uniform provisions on the topics mentioned above, the Working Group may wish to consider whether, with a view to encouraging and facilitating settlement of disputes by conciliation, it would be useful to prepare harmonized model provisions on other related matters, outlined below.

(a) *Admissibility or desirability of conciliation by arbitrators*

44. The UNCITRAL Arbitration Rules do not deal with the question whether and, if so, to what extent an arbitrator is permitted to raise during arbitral proceedings the possibility of a settlement.

45. It has been observed in the UNCITRAL Notes on Organizing Arbitral Proceedings that:

> "Attitudes differ as to whether it is appropriate for the arbitral tribunal to bring up the possibility of settlement. Given the divergence of practices in this regard, the arbitral tribunal should only suggest settlement negotiations with caution. However, it may be opportune for the arbitral tribunal to schedule the proceedings in a way that might facilitate the continuation or initiation of settlement negotiations." (para. 47).

46. Some States desiring the clarification that, subject to the parties' agreement, it is not a violation of arbitral procedures if the arbitrators facilitate settlement, have adopted provisions such as that it is not incompatible with an arbitration agreement for an arbitral tribunal to encourage settlement of the dispute, and that, with the agreement of the parties, the arbitral tribunal may use mediation, conciliation or other proceedings to encourage settlement.

47. Other jurisdictions have gone further and included in their laws provisions encouraging the arbitral tribunal to conciliate between the parties, without expressly linking that encouragement to the agreement of the parties.

48. Given the different practices and attitudes with regard to this question, it may be difficult to elaborate a single uniform rule that would attract equal support in different jurisdictions. If, however, the Working Group considers that a model legislative provision or provisions should be prepared, it may be useful to distinguish three possible concepts of a provision. According to one concept, the provision would be limited to recognizing that the arbitral tribunal may conduct and schedule the proceedings in such a way that would facilitate settlement negotiations, without itself suggesting or participating in them. Another concept may be to recognize the discretion of the arbitral tribunal to recommend to the parties to try to settle the dispute, but the arbitral tribunal should not participate in the negotiations. A further concept may be to state that it is not incompatible with the role of the arbitral tribunal to suggest to the parties to settle the dispute, and, to the extent agreed by the parties, to participate in the efforts to reach an agreed settlement.

(b) *Effect of an agreement to conciliate on judicial or arbitral proceedings*

49. Article 16 of the UNCITRAL Conciliation Rules provides that:

> "The parties undertake not to initiate, during the conciliation proceedings, any arbitral or judicial proceedings in respect of a dispute that is the subject of the conciliation proceedings, except that a party may initiate arbitral or judicial proceedings where, in his opinion, such proceedings are necessary for preserving his rights".

50. Some jurisdictions have adopted legislative provisions modelled on this rule; but, instead of casting them in terms of an undertaking of the parties as has been done in the cited article 16, they have provided that the parties shall not initiate, during the conciliation proceedings, any arbitral or judicial proceedings in respect of a dispute that is the subject of the conciliation proceedings, except that a party may initiate arbitral or judicial proceedings where, in its opinion, such proceedings are necessary for preserving its rights. Other laws, however, have provided that the conciliation agreement is deemed to be an agreement to stay all judicial or arbitral proceedings from the commencement of the conciliation until its termination. It appears that the expression "stay" in such laws is to be understood as a stay of any existing judicial or arbitral proceeding as well as a bar to initiation of a new proceeding. If the Working Group considers that it would be desirable to prepare a uniform provision restricting the parties to initiate arbitral or judicial proceedings, it may be necessary to define the moment when conciliation proceedings are deemed to have commenced (such a definition may be inspired by art. 2 of the UNCITRAL Conciliation Rules).

51. To the extent the conciliation rules agreed upon by the parties expressly permit or assume that a party may terminate the conciliation at any time (either informally or by a written declaration), a legislative provision preventing the commencement of arbitral or judicial proceedings will have little effect in the sense that a party will be able to overcome the obstacle by terminating the conciliation proceedings. If, however, participation in conciliation proceedings is regarded as an obligation (which is in some States provided for by law and is subject to mandatory time periods) or there are restrictions on the right to terminate conciliation proceedings (e.g. before a first settlement proposal has been made), a legislative provision modelled on article 16 of the UNCITRAL Conciliation Rules may constitute a real obstacle to initiating arbitral or court proceedings.

52. The positions in national laws differ as to the binding nature of an agreement to conciliate or as to the statutory duty to conciliate before resorting to adversary proceedings. Some countries have introduced the notion that parties in dispute are obliged to participate in conciliation

proceedings in order to foster conciliation and reduce adversary court or arbitration proceedings. In light of this, the Working Group may wish to combine its considerations of a possible model legislative provision restricting the initiation of arbitral or judicial proceedings with the discussion of whether it is advisable (and if so to what extent) to regard an agreement of the parties to conciliate as obligatory (in the sense that a party's right to refuse to conciliate or to terminate a conciliation would be subject to time periods or conditions), and whether harmonized guidance by the Commission to legislators on this point would be desirable. The approach taken by the UNCITRAL Conciliation Rules on this latter question is that a party may at any time terminate the conciliation proceedings by a written declaration to the other party and the conciliator. The main reason of this approach is that, despite the general policy that conciliation is to be stimulated, conciliation proceedings in a dispute in which at least one party is less than willing to arrive at a settlement are unlikely to be successful and that the time and money spent in such cases is likely to be spent in vain.

(c) *Effect of conciliation on the running of the limitation period*

53. Article 16 of the UNCITRAL Conciliation Rules, cited above in paragraph 49, is based on the assumption that conciliation proceedings do not interrupt the running of a limitation period. The purpose of article 16 is to permit the conciliation to proceed and at the same time allow the creditor to preserve its rights by initiating arbitral or judicial proceedings. Without article 16, a creditor may be put in an undesirable position in which it would see it as being in its best interest to terminate the conciliation proceedings and commence judicial or arbitral proceedings not because the conciliation does not offer a hope of success but because the creditor does not wish to risk a failed conciliation while its right would become unenforceable as a result of the expiration of the limitation period. In some legal systems the creditor and the debtor may address this dilemma by an agreement to extend the running of a prescription or limitation period; such an agreement would allow the creditor to continue participating in the conciliation proceedings without risking the loss of right as a result of the expiry of a time period. However, such arrangements between the creditor and the debtor are not allowed in all legal systems.

54. It has been said that, by allowing the initiation of arbitral or court proceedings, even if only for the purpose of preserving rights, costs are incurred and the conciliatory spirit between the parties may be spoiled. It would therefore be preferable, it is argued, if the initiation of conciliation itself would, by operation of law, interrupt the running of the prescription period. Some jurisdictions have adopted legislation to that effect.

55. The Working Group may wish to consider whether it would be useful to prepare a uniform provision on the effect of conciliation on the running of the limitation period. If such a provision is found to be desirable, it should be borne in mind that it should encompass all time periods whose expiry may affect rights, such as limitation periods and periods of prescription.

(d) *Communication between the conciliator and parties; disclosure of information*

56. In arbitration proceedings the arbitrator must treat the parties with equality and each party must be given a full opportunity to present its case. That principle (enshrined in art. 18 of the UNCITRAL Model Law) prevents an arbitrator from communicating with or meeting one party to the exclusion of the other. However, in conciliation proceedings (where the dispute can be resolved only by agreement of the parties as opposed to a binding decision) such a strict rule is not considered necessary, and it is widely regarded as permissible for the conciliator to meet or communicate with the parties together or with each of the parties separately. The possibility of such separate communication between the conciliator and a party is provided for in article 9(1) of the UNCITRAL Conciliation Rules, which reads:

> "The conciliator may invite the parties to meet with him or may communicate with them orally or in writing. He may meet or communicate with the parties together or with each of them separately."

57. Some States have included this principle in their national laws on conciliation by providing that a conciliator is allowed to communicate with the parties collectively or separately.

58. Another reflection of the principle of equality of parties is the principle, generally accepted to be an indispensable part of arbitral procedures (and contained in art. 24 of the UNCITRAL Model Law), that any factual information concerning the dispute that the arbitral tribunal receives from one party must be communicated to the other party, so as to give each party a full opportunity of presenting its case. Again, in conciliation proceedings it is considered permissible to relax somewhat this principle. Thus, article 10 of the UNCITRAL Conciliation Rules provides:

> "When the conciliator receives factual information concerning the dispute from a party, he discloses the substance of that information to the other party in order that the other party may have the opportunity to present any explanation which he considers appropriate. However, when a party gives any information to the conciliator subject to a specific condition that it be kept confidential, the conciliator does not disclose that information to the other party."

59. Some States have incorporated the principle contained in article 10 of the UNCITRAL Conciliation Rules into their law on conciliation. One question that arises in connection with such a provision concerns a case where the conciliator who has obtained information subject to a specific condition that it be kept confidential later becomes an arbitrator in the same dispute (because the conciliation has ended unsuccessfully and the conciliator is validly appointed as arbitrator). In such a case it may be considered appropriate or imperative that the information be made available to all parties in accordance with the general principles applicable to arbitral proceedings. Some laws that allow the conciliator to receive information subject to a specific condition of confidentiality provide that, when conciliation proceedings terminate without settlement, the arbitrator who has received such information must disclose

as much of that information as he or she considers material to the arbitral proceedings.

60. The Working Group may wish to consider whether it would be useful to elaborate *(a)* a model provision permitting the conciliator to meet or communicate with the parties together or with each of the parties separately and *(b)* a model provision according to which the conciliator does not disclose to all parties information received from one party subject to a specific condition of confidentiality. A possible benefit of such provisions is that they would eliminate doubts as to the propriety of procedures such as those contained in article 9 and 10 of the UNCITRAL Conciliation Rules and, to the extent conciliation is given certain effects (e.g. enforceability of a settlement agreement or the interruption of the prescription period), those effects would not be called into question if those procedures are used.

(e) *Role of conciliator*

61. Conciliation rules often contain principles that should guide the conciliator in conducting the proceedings. For example article 7 of the UNCITRAL Conciliation Rules provides:

"(1) The conciliator assists the parties in an independent and impartial manner in their attempt to reach an amicable settlement of their dispute.

"(2) The conciliator will be guided by principles of objectivity, fairness and justice, giving consideration to, among other things, the rights and obligations of the parties, the usages of the trade concerned and the circumstances surrounding the dispute, including any previous business practices between the parties.

"(3) The conciliator may conduct the conciliation proceedings in such a manner as he considers appropriate, taking into account the circumstances of the case, the wishes the parties may express, including any request by a party that the conciliator hear oral statements, and the need for a speedy settlement of the dispute.

"(4) The conciliator may, at any stage of the conciliation proceedings, make proposals for a settlement of the dispute. Such proposals need not be in writing and need not be accompanied by a statement of the reasons therefor."

62. Some national laws have included some of these guiding principles in their laws on conciliation. The Working Group may wish to consider whether it would be useful to elaborate a model provision that would set out such principles. Such a provision may be useful in that it would contribute to harmonizing standards of conciliation and thereby facilitate and promote its use in international trade.

II. ENFORCEABILITY OF INTERIM MEASURES OF PROTECTION

A. General remarks

63. Arbitral tribunals, in response to a request of a party, often order interim measures of protection before issuing an award in the dispute. Such measures, directed to one or both of the parties, are referred to by expressions such as "interim measures of protection", "provisional orders", "interim awards", "conservatory measures" or "preliminary injunctive measures". The purposes of such measures differ and may include the following:

(a) Measures aimed at facilitating the conduct of arbitral proceedings, such as orders requiring a party to allow certain evidence to be taken (e.g. to allow access to premises to inspect particular goods, property or documents); orders for a party to preserve evidence (e.g. not to make certain alterations at a site); orders to the parties and other participants in arbitral proceedings to protect the privacy of the proceedings (e.g. to keep files in a certain place under lock or not to disclose the time and place of hearings);

(b) Measures to avoid loss or damage and measures aimed at preserving a certain state of affairs until the dispute is resolved, such as orders to continue performing a contract during the arbitral proceedings (e.g. an order to a contractor to continue construction works despite its claim that it is entitled to suspend the works); orders to refrain from taking an action until the award is made; orders to safeguard goods (e.g. to take specific safety measures, to sell perishable goods or to appoint an administrator of assets); orders to take the appropriate action to avoid the loss of a right (e.g. to pay the fees needed to extend the validity of an intellectual property right); orders relating to the clean-up of a polluted site;

(c) Measures to facilitate later enforcement of the award, such as attachments of assets and similar acts that seek to preserve assets in the jurisdiction where enforcement of the award will be sought (attachments may concern, for example, physical property, bank accounts or payment claims); orders not to move assets or the subject-matter of the dispute out of a jurisdiction; orders for depositing in a joint account the amount in dispute or for depositing movable property in dispute with a third person; orders to a party or parties to provide security (e.g. a guarantee) for costs of arbitration or orders to provide security for all or part of the amount claimed from the party.

64. Interim measures of protection may concern assets or property located in the jurisdiction where the arbitration takes place or outside that jurisdiction.

65. The above enumeration of possible interim measures of protection is not exhaustive. Arbitration rules that provide for their issuance typically do not provide a hard and fast definition of the scope of measures that an arbitral tribunal may issue. Often the formulations in the arbitration rules are rather broad; for example, they provide generally that the arbitral tribunal is allowed to take the interim measures it deems necessary in respect of the subject-matter of the dispute; in some cases examples of measures that may be ordered are included (for example, art. 26(1) of the UNCITRAL Arbitration Rules). Some rules empower the arbitral tribunal in broad terms to order on a provisional basis, subject to final determination in the award, any relief which the arbitral tribunal would have power to grant in an award.

66. The temporary nature of interim measures of protection is reflected in the expectation (which is also stated in some arbitration laws) that any interim measure ordered by an arbitral tribunal may be reviewed and altered by the arbitral tribunal and that, in any event, it should be subject to the arbitral tribunal's final adjudication, with the award taking account of any previously ordered interim measure of protection. However, an interim measure, in its own terms, may have final and significant consequences that cannot be reversed even if the measure is later modified or turns out to be unnecessary in the light of the final award.

67. Some interim measures of protection are issued ex parte, that is on the application of one party without hearing the other affected party before ordering the measure. Arbitration statutes usually do not contain provisions on the possibility of ordering ex parte measures and do not specify which types of measures may be ordered ex parte. Among the reasons given in arbitral awards for issuing ex parte measures are the following: showing that irreparable loss or damage will occur without the measure, particular urgency that does not allow hearing the other party (e.g. measures concerning perishable goods) or desirability of not giving advance notice of the measure to the party to whom the measure is directed (e.g. a hearing on a requested measure not to remove assets from the jurisdiction may allow the party to remove the assets before the measure is issued).

68. Neither statutory provisions governing arbitral procedures nor arbitration rules normally contain express provisions as to whether a decision on an interim measure of protection should state the reasons upon which it is based. Generally, it appears, arbitral tribunals issue reasoned decisions.

B. Power to order interim measures

69. Legislative solutions regarding the power of the arbitral tribunal to order interim measures of protection are not uniform. In some jurisdictions, the power is implied. In other jurisdictions there are express provisions empowering the arbitral tribunal to order interim measures. Such is the case, for example, in jurisdictions that have adopted legislation based on the UNCITRAL Model Law on International Commercial Arbitration. Article 17 of the Model Law provides the following:

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

70. According to some arbitration laws, the power of the arbitral tribunal to order interim measures of protection depends on the agreement of the parties, and the law limits itself to recognizing the effectiveness of parties' agreement to grant such power to the arbitral tribunal. There are also jurisdictions where the arbitral tribunal is deemed not to have the power to order interim measures and it is considered that the parties cannot confer such power on the arbitral tribunal.

71. Pursuant to many sets of arbitration rules, an arbitral tribunal is given the power to order interim measures. For example, article 26(1) of the UNCITRAL Arbitration Rules provides as follows:

> "At the request of either party, the arbitral tribunal may take any interim measures it deems necessary in respect of the subject-matter of the dispute, including measures for the conservation of the goods forming the subject matter in dispute, such as ordering their deposit with a third person or the sale of perishable goods."

72. In many jurisdictions the parties can choose between requesting an interim measure of protection from the arbitral tribunal and requesting it from a court. When the arbitral tribunal has not yet been constituted, and a party wishes an interim measure of protection, approaching the court is the only possibility. This possibility of requesting an interim measure from the arbitral tribunal or from the court is envisaged also in the UNCITRAL Model Law, which, in addition to empowering the arbitral tribunal to issue interim measures (see above-cited art. 17), provides in article 9:

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

Article 9 of the Model Law limits itself to declaring that it is not incompatible with the arbitration agreement for the court to issue an interim measure. Whether and to what extent the court is in fact empowered to issue such measure in favour of an ongoing arbitration is left to legislative provisions outside the Model Law.

C. Arguments in favour of enforceability of interim measures ordered by arbitral tribunal

73. As arbitrators do not have coercive powers to enforce interim measures of protection, practitioners have in recent years argued in various forums that the question of enforceability of interim measures of protection is an issue to be considered by legislators. The need for enforceability is usually supported by arguments such as that the final award may be of little value to the successful party if actions of the recalcitrant party have rendered the outcome of the proceedings largely useless (e.g. by dissipating assets or removing them from the jurisdiction); or that preventable loss or damage should not be allowed to happen (e.g. if a party refuses to take precautionary measures at the construction site or it fails to continue construction works while the dispute is being resolved). Thus, it is argued, in some cases an interim order may in practice be as important as the award.

74. In connection with arguments in favour of enforceability of interim measures of protection, it has been pointed out that international arbitrations are often held in places where neither party has assets or commercial operations (so called "neutral" places). This often means that the action to be taken pursuant to an interim measure ordered by the arbitral tribunal is to be taken outside of the jurisdiction where the arbitration takes place. Therefore, to the

extent it is possible to establish a regime for court assistance in enforcing interim measures, there should be a possibility for enforcement by courts in both the State of arbitration as well as outside that State.

75. It should be noted, however, that, as a practical matter, interim measures issued by arbitral tribunals are often effective without any court coercion. Circumstances fostering the effectiveness of measures are, for example, that the party does not wish to displease the arbitral tribunal, whom the party wishes to convince that its position is justified; that the arbitral tribunal may draw adverse inferences from a refusal to comply with the measure (e.g. in case of an order to preserve a certain piece of evidence); that the arbitral tribunal may proceed to make an award on the basis of materials before it; and that the arbitral tribunal might hold the recalcitrant party liable for costs or damages arising from its non-compliance with the measure and include that liability in the award. Nevertheless, it has been pointed out that there are many instances where interim measures of protection remain unheeded, and that the incentives just mentioned may not be sufficient or effective.

76. Some propose that arbitration parties in need of enforceable interim measures should resort to the judicial process, as is possible under many national laws. However, in response, it is pointed out that this may pose difficulties. For example, obtaining a court measure may be a lengthy process, in particular, because the court may require arguments on the issue or because the court decision is open to appeal. Furthermore, the courts of the place of arbitration may not have effective jurisdiction over the parties or the assets. Since arbitrations are often conducted in a State that has little or nothing to do with the subject-matter in dispute, a court in another State may have to be approached with a request to consider and issue a measure. Moreover, the law in some jurisdictions may not offer parties the option of requesting the court to issue interim measures of protection, on the ground that the parties, by agreeing to arbitrate, are deemed to have excluded the courts from intervening in the dispute; even if the courts would have the jurisdiction to order an interim measure, a court may be reluctant to order it on the ground that it is more appropriate for the arbitral tribunal to do so.

77. It is therefore argued that resources would be used more efficiently if parties were able to make their requests for interim measures directly to the arbitral tribunal rather than to the court and if measures would be enforceable by intervention of the court in an expedited fashion. Such a possibility is said to be desirable, in particular since the arbitral tribunal is already familiar with the case, is often technically apprised of the subject-matter and may make a decision in a shorter time than the court.

78. In discussing these arguments, the Working Group might wish to bear in mind that the need for efficient court-assisted enforceability of interim measures is not the same for all interim measures that may be issued by an arbitral tribunal. For example, when arbitral tribunals order interim measures mentioned under *(a)* in paragraph 63 (those aimed at facilitating the conduct of arbitral proceedings), and a party fails to comply with one of those measures, the arbitral tribunal may "draw adverse inferences" from the failure and make the award on the basis of information and evidence before it. In addition or alternatively, the arbitral tribunal may take the party's failure to comply with the measure into account in its final decision on costs of the proceedings. Thus, with respect to these kinds of measures, the arbitral tribunal may have considerable leverage over the parties, which may reduce the need for court intervention.

79. When the measure is of the kind mentioned under *(b)* in paragraph 63 (a measure to avoid irreparable loss or damage or to preserve a certain state of affairs until the dispute is resolved), the arbitral tribunal would also normally be able to hold the party liable for costs or damages caused by its failure to comply with the order. Nevertheless, despite the possibility of liability for costs and damages, the failure to comply with the measure may have severe and irreparable consequences, and it might be regarded as being in the interests of an orderly administration of justice that there exist a possibility of court assistance in the enforcement of such a measure ordered by an arbitral tribunal.

80. When the measure is one of those mentioned under *(c)* in paragraph 63 (a measure to facilitate later enforcement of the award), and a party is determined to attempt to thwart the enforcement of the award, the arbitral tribunal or the interested party may have no effective means to avoid the negative consequences of a party's failure to abide by the interim measure. In practice, this may mean that the award will remain largely useless to the winning party. Thus, in view of the magnitude of the problem potentially resulting from a recalcitrant party and the lack of effective means available to the arbitral tribunal or the other party to avoid the problem, the need for court assistance in enforcing interim measures of this type may be the greatest.

D. Considerations of the Commission

81. When the Commission discussed the question of enforceability of interim measures of protection ordered by arbitral tribunals (A/54/17, para. 371), it was generally agreed that this question was of utmost practical importance which in many legal systems was not dealt with in a satisfactory way. It was considered that solutions to be elaborated by the Commission on that topic would constitute a real contribution to the practice of international commercial arbitration. It was also agreed that the issue should be addressed through legislation.

82. As to the substance of possible solutions, several observations and suggestions were made in the Commission (A/54/17, para. 372). One was that, in addition to the enforcement of interim measures of protection in the State where the arbitration took place, enforcement of those measures outside that State should also be considered. It was said that, while the possible objective of future work was to make interim measures of protection enforceable in a similar fashion as arbitral awards, it should be borne in mind that interim measures of protection in some important respects differed from arbitral awards (e.g. an interim measure might be issued ex parte, and might be reviewed by the arbitral tribunal in light of supervening

circumstances). As to ex parte measures, it was observed that under some legal systems they could only be issued for a limited period of time (e.g. 10 days), and a hearing had to be held thereafter to reconsider the measure. Court assistance to arbitration (in the form of interim measures of protection issued by a court before the commencement of, or during, arbitral proceedings) was also suggested for study.

E. Current legislative solutions

(a) *New York Convention*

83. Sometimes arbitral tribunals issue interim measures of protection in the form of interim awards. Such a possibility is expressly envisaged, for example, in article 26(2) of the UNCITRAL Arbitration Rules. This raises the question of whether the Convention on the Recognition and Enforcement of Foreign Arbitral Awards covers also such interim awards. As the Convention does not define the term "award", it is not immediately clear whether the Convention applies to interim awards as well. The prevailing view, confirmed also by case law in some States, is that the Convention does not apply to interim awards.

(b) *UNCITRAL Model Law*

84. The UNCITRAL Model Law on International Commercial Arbitration expressly deals in article 17 with the power of the arbitral tribunal to order such interim measure of protection as it may consider necessary and also to require a party to provide appropriate security in connection with such measure. The Model Law, however, is silent on the matter of enforcement.

85. When, during the preparation of the Model Law, the substance of article 17 was considered by the Working Group, it contained a sentence that "if enforcement of any such interim measure becomes necessary, the arbitral tribunal may request [a competent court][the Court specified in article V] to render executory assistance".[5] Under one view in the Working Group, executory assistance by courts was considered desirable and should be available. Under another view, which the Working Group adopted after deliberation, the sentence was to be deleted since it dealt in an incomplete manner with a question of national procedural law and court competence and was unlikely to be accepted by many States. It was understood by the Working Group, however, that the deletion of the sentence should not be read as a precluding executory assistance in those cases where a State was prepared to render such assistance under its procedural law.[6]

(c) *National laws*

86. In respect of enforceability of interim measures issued by an arbitral tribunal, a variety of approaches have been taken by legislatures. In many States the legislation is silent on this point. In others, there are express provisions for enforcement of those interim measures.

87. In several jurisdictions, the legislation provides that the provisions on recognition and enforcement of awards apply also to orders made by the arbitral tribunal.

88. In some jurisdictions the law provides that, when a party does not comply with the order by the arbitral tribunal, the arbitral tribunal may request assistance from the court for the enforcement of the order; in other jurisdictions, a party may request such assistance, and in yet others either the arbitral tribunal or the party may request it.

89. One law provides that the court may make an order requiring a party to comply with a "peremptory" order made by the tribunal. The application can either be made by the tribunal upon notice to the parties or by a party with permission of the tribunal and upon notice to the other party. This procedure can only be followed once any available arbitral process has been exhausted and a reasonable period of time has been given to the other party to comply with the order.

90. Another law states that a court may permit enforcement of an arbitrator-granted interim measure of protection unless application for a corresponding interim measure of protection has already been made to a court. The court is empowered to recast such an order if necessary for the purpose of enforcing the measure. The court may also, upon request, repeal or amend the decision to enforce the order. Furthermore, it is provided that if a measure ordered by the arbitral tribunal proves to have been unjustified from the outset, the party who obtained its enforcement is obliged to compensate the other party for damage.

91. In several jurisdictions it is stated that when a party applies to a court for interim measures and the arbitral tribunal has already ruled on any matter relevant to the application, the court is to treat the ruling or any finding of fact made in the course of the ruling as conclusive for the purposes of the application.

F. Possible harmonized solutions

(a) *Domestic and foreign interim measures*

92. As noted above in paragraph 74, the place of arbitration in international arbitral cases is often chosen for reasons of convenience of the parties and the arbitrators and the availability of certain services, rather than because of any connection with the subject-matter of the dispute. In such circumstances, many measures issued in such arbitrations may have to implemented outside the State where the arbitration takes place. However, also where an international arbitration takes place in the State where the subject-matter of the dispute is located, the arbitral tribunal may well issue measures that would have to be carried out in other States. In light of that, the Working Group may consider that it would be desirable to elaborate a system that would allow court enforcement of measures issued in arbi-

[5]Report of the Working Group on International Contract Practices on the work of its sixth session (1983), doc. A/CN.9/245, *UNCITRAL Yearbook*, vol. XV: 1984, part two, II, A, 1, para. 70.

[6]Ibid., para. 72.

trations taking place either in the State of the enforcing court or outside that State. To the extent any different treatment for foreign measures should be called for, this might be provided by way of specified exceptions.

(b) *Subjecting interim measures to provisions on recognition and enforcement of awards*

93. One possible approach for consideration of the Working Group might be to devise a solution according to which the enforcing court would treat an interim measure, for the purpose of its enforcement, as an award and apply to it the provisions governing the recognition and enforcement of awards. (In the context of the UNCITRAL Model Law on International Commercial Arbitration, provisions on the recognition and enforcement of arbitral awards, whether issued in the State of enforcement or outside that State, are contained in its articles 35 and 36.) Such an approach has been adopted in several jurisdictions. For example, it has been provided that, unless otherwise agreed by the parties, the provisions on the recognition and enforcement of awards apply to orders made by the arbitral tribunal for interim measures of protection as if a reference to an award in those provisions were a reference to such an order. In some jurisdictions, enforcement of interim measures is subjected to the enforcement regime for arbitral awards only if the parties have so agreed. It should be noted, however, that the national solutions just referred to apply to arbitrations taking place in those States. There is no provision in those laws for the enforcement of measures issued in arbitrations taking place in a foreign country.

94. The Working Group may wish to discuss whether this approach is to be taken as the basis for elaborating a harmonized regime for the enforcement of interim measures. The advantage of this approach may be that it would take as a basis a regime that has been tested in practice.

95. A further question to be discussed may be whether a regime based on this approach lends itself to being extended also to interim measures issued by an arbitral tribunal outside the State of the court requested to enforce the measure. A consideration in deciding whether to extend such a regime to foreign measures may be that concepts of interim measures in legal systems differ and thus the court may be faced with a request for an interim measure not known or uncommon in its legal system. For example, some systems recognize ex parte measures to a greater degree than others. Another example may be the practice of arbitral tribunals in some States of issuing "peremptory" interim measures to which sanctions are attached by the arbitral tribunal in case they are not complied with. In a further example, if the measure ordered by the arbitral tribunal does not state the reasons on which it is based or if the reasons are not sufficient, the enforcing court may have difficulty enforcing the measure because of a limited possibility of assessing the implicated public policy considerations. Furthermore, the arbitration legislation in the State of the enforcing court may exclude from the powers of an arbitral tribunal certain types of interim measures (e.g. attachment of property or of certain types of property).

96. It may be noted, however, that even when the measure has been issued by an arbitral tribunal in the State where the measure is to be enforced, the court may have to deal with measures that are not known or are unusual in that State. This is so because the procedural law on arbitration generally leaves broad latitude to the parties and the arbitral tribunal in determining the procedure to be followed in conducting the proceedings (see, e.g. art. 19 of the UNCITRAL Model Law) and therefore the arbitral tribunal may follow rules and practices for the issuance of interim measures that are different from those generally used in the State where the arbitration takes place.

97. In the situations described above courts may be reticent to enforce such measures whether they are issued in the State of the enforcing court or outside the State. To the extent enforcement of such interim measures presents a difficulty, it might be overcome by a solution that would make enforceable only those measures that are in compliance with certain procedural conditions of the State of the enforcing court. For example, an ex parte measure may be enforceable after the court is satisfied that both parties have been able to present their cases. It may, however, be considered too difficult to formulate a harmonized set of conditions for enforcement of different types of interim measures, including those that are not known or are unusual in the State of enforcement. Another approach, more flexible and more accommodating of differences in procedural systems, may be to leave the court discretion as to the manner of enforcement of an interim measure.

(c) *Giving the court discretion in enforcing a measure*

98. The Working Group may wish to consider whether the regime to be adopted should allow the enforcing court a degree of discretion as to how the measure is to be enforced, possibly also as to whether it is to be enforced, including discretion to adapt the interim measure to the procedural and enforcement system of the court. Such an adaptation may involve amending or recasting the wording of the order. The advantage of an approach which would rely to some extent upon the discretion of the court enforcing the measure would be that, while it would provide a clear legislative basis for enforcement of interim measures, both domestic and foreign, it would not impinge upon the procedural and enforcement system of the State. This would allow the development of court practices with respect to enforcement of such interim measures, hopefully in a manner that would be supportive of arbitration.

99. If the court is to be given a degree of discretion in enforcing interim measures ordered by arbitral tribunals, the question that may need to be discussed is whether the requesting party would need to present arguments to the court to convince it that the measure is necessary. For example, would the party requesting enforcement need to prove in court the facts showing the need for the measure and present arguments as to the form and amount of any security that should be provided? Furthermore, should the other party be heard on those issues? If such arguments are to be heard again in court, after the arbitral tribunal itself has heard them, the process of enforcement may become lengthy. Therefore, the Working Group may wish to

consider whether it should be provided that the court is allowed, or obligated, to take the arbitral tribunal's factual findings as conclusive.

(d) *Special provisions reflecting the interim nature of measures of protection*

100. As noted above in paragraph 66, the measures of protection discussed here are interim or temporary in relation to the final award. They do not represent the final resolution of the dispute in that they might be modified by the arbitral tribunal as matters evolve during the arbitral proceedings, and that they should be taken into account and merged in the arbitral tribunal's final adjudication of the dispute. This feature distinguishes interim measures from arbitral awards and may call for special provisions on the enforcement of interim measures.

101. One such special provision may be required because, at the time of the request for enforcement or at some time thereafter but before the issuance of the award, the arbitral tribunal might modify its interim measure because circumstances have changed (e.g. the respondent is able to show that it has sufficient assets in the jurisdiction, which may allow the arbitral tribunal to lift or modify the earlier order prohibiting the removal of certain assets from the jurisdiction; or the danger of irreparable damage as the ground for continued performance of a construction contract may disappear, which would permit the earlier interim order to be amended). In order to deal with this, the Working Group may wish to consider the need for a provision empowering the court to modify its order for the enforcement of an interim measure ordered by an arbitral tribunal. Furthermore there may be a need for a provision making a court order for the enforcement of a measure dependent on the obligation of the requesting party to inform the court promptly of any amendment of the measure by the arbitral tribunal. In addition, provision may have to be made for appropriate security from the party requesting court assistance in the enforcement of the interim measure.

G. Scope of interim measures that may be issued by arbitral tribunal and procedures for issuance

102. In connection with the discussion on the enforcement of interim measures of protection, the Working Group may also wish to give consideration to the desirability and feasibility of preparing a harmonized text on the scope of interim measures of protection that an arbitral tribunal may issue and procedural rules for their issuance.

103. Many laws have broad formulations empowering the arbitral tribunal to order interim measures of protection. In this group are the jurisdictions that have adopted article 17 of the Model Law, according to which the arbitral tribunal may order "such interim measure of protection as the arbitral tribunal may consider necessary in respect of the subject-matter of the dispute". In some laws the formulations are more specific; for example, arbitrators are expressly empowered to issue attachment orders or to order the property in dispute to be deposited with a third party. Other laws have more restrictive formulations; for instance, it is provided that arbitrators do not have the power to issue attachments of property.

104. Reports from practitioners and arbitral institutions indicate that parties are seeking interim measures in an increasing number of cases. This trend and the lack of clear guidance to arbitral tribunals as to the scope of interim measures that may be issued and the conditions for their issuance may hinder the effective and efficient functioning of international commercial arbitration. To the extent arbitral tribunals are uncertain about issuing interim measures of protection and as a result refrain from issuing the necessary measures, this may lead to undesirable consequences, for example, unnecessary loss or damage may happen or a party may avoid enforcement of the award by deliberately making assets inaccessible to the claimant. Such a situation may also prompt parties to seek interim measures from courts instead of the arbitral tribunals in situations where the arbitral tribunal would be well placed to issue an interim measure; this causes unnecessary cost and delay (e.g. because of the need to translate documents into the language of the court and the need to present evidence and arguments to the judge).

105. The Working Group may wish to consider whether it would be desirable to prepare a harmonized text dealing with the issuance of interim measures by arbitral tribunals. Such a text might be in the form of uniform legislative provisions or in the form of a non-legislative text such as model contractual rules on which parties could agree. A further possibility might be to prepare guidelines or practice notes to assist parties and arbitrators. Such guidelines or practice notes might describe and analyse the differences in various types of interim measures, the criteria applied by arbitral tribunals in determining whether to order particular interim measures, the procedures relating to seeking and ordering interim measures and means by which an arbitral tribunal can itself apply sanctions to enforce certain interim measures as contrasted with other types of measures where court assistance is needed.

106. If it is considered that work should be undertaken in this direction, some inspiration may be drawn from the Principles on Provisional and Protective Measures in International Litigation, which were adopted in 1996 by the Committee on International Civil and Commercial Litigation of the International Law Association (ILA).[7] The Principles, reproduced below in paragraph 108, are limited to provisional and protective measures that may be issued by courts; however, a number of ideas underlying the Principles appear to be relevant, mutatis mutandis, also to interim measures ordered by arbitral tribunals.

107. If work regarding the issuance of interim measures by arbitral tribunals appears promising, the Working Group may wish to exchange views on the topic, including on the possible form of the text to be adopted, and request the secretariat to prepare a study to facilitate its further considerations. This topic appears sufficiently separate from the

[7]The International Law Association, report of the Sixty-seventh Conference held at Helsinki, Finland, 12 to 17 August 1996, published by the International Law Association, London 1996, pp. 202-204.

topic of the enforcement of interim measures (discussed above in paragraphs 63 to 102), so that it might be found that the two topics should be dealt with differently; for example, one in a non-legislative text while the other in a legislative text.

108. The text of the ILA Principles on Provisional and Protective Measures in International Litigation is as follows:

Scope of principles

1. Provisional and protective measures perform two principal purposes in civil and commercial litigation:

(a) to maintain the status quo pending determination of the issues at trial; or

(b) to secure assets out of which an ultimate judgement may be satisfied.

2. These principles are intended to be of general application in international litigation. But they were drafted bearing in mind a paradigm case under category *(b)* above of measures to freeze the assets of the defendant held in the form of sums on deposit in a bank account with a third party bank.

Nature of the remedy

3. States should make available without discrimination provisional and protective measures with the objective of securing assets out of which an ultimate judgement may be satisfied.

4. The grant of such relief should be discretionary. It should be available:

(a) on a showing of a case on the merits on a standard of proof which is less than that required for the merits under the applicable law; and

(b) on a showing that the potential injury to the plaintiff outweighs the potential injury to the defendant.

5. The defendant should not be entitled to hide his assets behind a corporate veil or other subterfuge.

6. The plaintiff should ensure that the defendant be informed promptly of the order, notwithstanding any formal legal requirements for service of the order and the legal consequences which may flow from service.

7. The defendant should have the right to be heard within a reasonable time and to object to the provisional and protective measure ordered.

8. The court should have authority to require security or other conditions from the plaintiff for the injury to the defendant or to third parties which may result from the granting of the order. In determining whether to order security, the court should consider the availability of the plaintiff to respond to a claim for damages for such injury.

9. Provision should be made for access to information either through operation of law or by court order in appropriate cases as to the defendant's assets.

Ancillary proceedings

10. The jurisdiction to grant provisional and protective measures should be independent from jurisdiction on the merits.

11. The mere presence of assets within a country should be a sufficient basis for the jurisdiction to grant provisional and protective measures in respect of those assets.

12. It should be a condition for the court exercising jurisdiction to grant provisional and protective measures that a substantive action is filed within a reasonable time either in the forum (if it has substantive jurisdiction) or abroad (but the court shall not act in aid of a substantive action abroad if there is no reasonable possibility of the judgement rendered on the substance in the foreign court being enforceable in the forum).

13. The provisional and protective measure should be valid for a specified limited time. The court should consider renewal in the light of developments in the court where the substantive action is underway.

14. There may be scope for the court exercising substantive jurisdiction to play a supervisory role, on the application of the defendant, over provisional and protective measures granted in other countries, considering in particular whether in aggregate those measures are justifiable in the light of the action as a whole, and the amount claimed in it.

15. The applicant for provisional and protective measures must inform the requested court of the current status of proceedings for provisional and protective measures and on the merits in other countries. The possibility is not even excluded of states conferring on their courts permission, where authorized, to communicate directly with relevant judicial authorities in other countries.

Territorial scope

16. Where the court is properly exercising jurisdiction over the substance of the matter, it should have the power to issue provisional and protective orders addressed to a defendant personally to freeze his assets, irrespective of their location.

17. Where the court is not exercising jurisdiction over the substance of the matter, and is exercising jurisdiction purely in relation to grant of provisional and protective measures, its jurisdiction shall be restricted to assets located within the jurisdiction. Subject to international law, national rules (including rules of the conflict of laws) will determine the location of assets.

Cross border recognition and international judicial assistance

18. At the request of a party, a court may take into account orders granted in other jurisdictions.

19. Further, a court should cooperate where necessary in order to achieve the efficacy of orders issued by other courts, and consider the appropriate local remedy.

20. This may require an extended recognition of foreign court orders. The fact that an order is provisional in nature, rather than final and conclusive, should not by itself be an obstacle to recognition or enforcement.

Forum arresti and forum patrimonii

21. The fact that the court has granted a provisional and protective measure does not in itself found jurisdiction over the substantive claim, whether or not limited to the value of the frozen assets.

Interim payments

22. The procedure in domestic law under which the court may order an interim payment (i.e. an outright payment to the plaintiff which may be subsequently revised on final judgement) is not a provisional and protective measure in the context of international litigation.

[Chapter III, "Requirement of written form for arbitration agreement", will be published in doc. A/CN.9/WG.II/WP.108/Add.1.]

A/CN.9/WG.II/WP.108/Add.1

CONTENTS

[Continuation of document A/CN.9/WG.II/WP.108]

III. REQUIREMENT OF WRITTEN FORM FOR ARBITRATION AGREEMENT

A. Introductory remarks

1. Many national laws require an arbitration agreement to be in writing for it to be enforceable. Such form requirements have been included also in international legislative texts on commercial arbitration.

2. Article II(2) of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958) defines the writing requirement in the following way:

> "The term 'agreement in writing' shall include an arbitral clause in a contract or an arbitration agreement, signed by the parties or contained in an exchange of letters or telegrams."

3. The European Convention on International Commercial Arbitration (Geneva, 1961), modelled on article II of the New York Convention, provides in article I(2):

> "2. For the purpose of this Convention,
>
> "*(a)* the term 'arbitration agreement' shall mean either an arbitral clause in a contract or an arbitration agreement, the contract or arbitration agreement being signed by the parties, or contained in an exchange of letters, telegrams, or in a communication by teleprinter and, in relation between States whose laws do not require that an arbitration agreement be made in writing, any arbitration agreement concluded in the form authorized by these laws".

4. That substance of the form requirement has been incorporated also in the Inter-American Convention on Inter-

national Commercial Arbitration (Panama, 1975), which provides in article 1:

> "An agreement in which the parties undertake to submit to arbitral decision any differences that may arise or have arisen between them with respect to a commercial transaction is valid. The agreement shall be set forth in an instrument signed by the parties, or in the form of an exchange of letters, telegrams, or telex communications."

5. Article 7(2) of the UNCITRAL Model Law on International Commercial Arbitration (1985) provides that:

> "The arbitration agreement shall be in writing. An agreement is in writing if it is contained in a document signed by the parties or in an exchange of letters, telex, telegrams or other means of telecommunication which provide a record of the agreement, or in an exchange of statements of claim and defence in which the existence of an agreement is alleged by one party and not denied by another. The reference in a contract to a document containing an arbitration clause constitutes an arbitration agreement provided that the contract is in writing and the reference is such as to make that clause part of the contract."

6. If the parties have agreed to arbitrate, but the form the parties used for entering into the arbitration agreement does not meet the legislative requirement of form, a party may be able to object to the jurisdiction of the arbitral tribunal. A party may be able to raise that objection, for example: *(a)* when court proceedings are initiated and the respondent requests that the parties be referred to arbitration, and the claimant in court proceedings counters that request with an assertion that the arbitration agreement is null and void (e.g. art. 8 of the UNCITRAL Model Law; art. III(3) of the New York Convention); *(b)* when the arbitral proceedings have commenced and a party in arbitral proceedings raises a plea that the arbitral tribunal does not have jurisdiction (e.g. art. 16(2) of the Model Law; art. V of the 1961 European Convention on International Commercial Arbitration); *(c)* when the award has been issued and a party applies for setting aside of the award (e.g. art. 34(2)*(a)*(i) together with art. 16(2) of the Model Law); *(d)* when a party applies for recognition or enforcement of the award and the respondent opposes the application (e.g. art. 36(1)*(a)*(i) together with art. 16(2) of the Model Law; art. V(1)*(a)* of the New York Convention).

7. It has been repeatedly pointed out by practitioners that there are a number of situations where the parties have agreed to arbitrate (and there is evidence in writing about the agreement), but where, nevertheless, the validity of the agreement is called into question because of the overly restrictive form requirement. The conclusion frequently drawn from those situations is that the definition of writing, as contained in the above-mentioned international legislative texts, is not in conformity with international contract practices and is detrimental to the legal certainty and predictability of commitments entered into in international trade.

8. Some national laws (as indicated in more detail below in paras. 29-32) have addressed the problem and broadened the definition of writing. While the problem of the outdated form requirement is thereby being dealt with, the fact that these laws contain different solutions creates other difficulties, caused by the disparity of laws. The Working Group may wish to consider that this disparity, which may grow in the future, increases the desirability of finding internationally harmonized solutions. Meanwhile, because the definition in international legislative texts as well as in many national laws has remained unchanged, undesirable consequences continue to arise. They are, for example, that parties may expect to be able to initiate arbitral proceedings, but their expectations are frustrated. Furthermore, courts, in order to reach results they consider appropriate under the circumstances, have to resort to expansive and even strained interpretations of the definition of writing. In addition, difficulties may arise when awards are rendered relying on laws providing a broader definition of writing but are brought for enforcement to a jurisdiction which has a narrower definition.

9. In light of the above, suggestions have been made that solutions should be sought which would, on the one hand, respect the notion that disputes may be settled by arbitration only if the parties have so agreed, and, on the other hand, validate legitimate contract practices and avoid problems and uncertainties in the practice of arbitration.

10. The following section B first considers typical fact situations in which the requirement that an arbitration agreement be "signed" by both parties or "contained in an exchange of letters" may cause problems and uncertainties. In the subsequent section C, which is related to the work of the Commission in the area of electronic commerce, the discussion is on how the requirement of writing is to be interpreted when the parties use electronic means of communication for agreeing to arbitrate.

B. "Document signed" or "exchange of documents"

11. Several fact situations may be given as typical examples of where the parties have agreed on the content of a contract containing an arbitration agreement and where there is written evidence of the contract, but where, nevertheless, current law (as contained in international texts referred to above in paras. 2 to 5) may be construed as invalidating or calling into question the validity of the arbitration agreement. This will happen where *(a)* the parties have not signed a document containing the arbitration agreement (which regularly occurs when the parties are not at the same place when concluding the contract) and where *(b)* the procedure used by the parties for concluding the contract does not meet the test of "exchange of letters or telegrams" (art. II(2) of the New York Convention), if that test is interpreted literally.

12. These fact situations include the following:

(a) A contract containing an arbitration clause is formed by one party sending written terms to the other, which performs its bargain under the contract without returning or making any other "exchange" in writing in relation to the terms of the contract;

(b) A contract containing an arbitration clause is formed on the basis of the contract text proposed by one party, which is not explicitly accepted in writing by the other party, but the other party refers in writing to that contract in subsequent correspondence, invoice or letter of credit by mentioning, for example, its date or contract number;

(c) A contract is concluded through a broker who issues the text evidencing what the parties have agreed upon, including the arbitration clause, without there being any direct written communications between the parties;

(d) Reference in an oral agreement to a written set of terms, which may be in standard form, that contain an arbitration agreement;

(e) Bills of lading which incorporate the terms of the underlying charter party by reference;

(f) A series of contracts entered into between the same parties in a course of dealing, where previous contracts have included valid arbitration agreements but the contract in question has not been evidenced by a signed writing or there has been no exchange of writings for the contract;

(g) The original contract contains a validly concluded arbitration clause, but there is no arbitration clause in an addendum to the contract, an extension of the contract, a contract novation or a settlement agreement relating to the contract (such a "further" contract may have been concluded orally or in writing);

(h) A bill of lading containing an arbitration clause that is not signed by the shipper or the subsequent holder;

(i) Third party rights and obligations under arbitration agreements in contracts which bestow benefits on third party beneficiaries or stipulation in favour of a third party *(stipulation pour autrui)*;

(j) Third party rights and obligations under arbitration agreements following the assignment or novation of the underlying contract to the third party;

(k) Third party rights and obligations under arbitration agreements where the third party exercises subrogated rights;

(l) Rights and obligations under arbitration agreements where interests in contracts are asserted by successors to parties, following the merger or demerger of companies, so that the corporate entity is no longer the same;

(m) Where a claimant seeks to initiate an arbitration against an entity not originally party to the arbitration agreement, or where an entity not originally party to the arbitration agreement seeks to rely on it to initiate an arbitration, for example, by relying on the "group of companies" theory.[1]

[1]The group of companies theory has been used to bring a parent company or a subsidiary under an arbitration agreement which has not been signed by it, but by other members of the group. The theory may be summarized as requiring (1) that the legally distinct company being brought under the arbitration agreement is part of a group of companies that constitutes one economic reality *(une réalité économique unique)*, (2) that the company played an active role in the conclusion and performance of the contract and (3) that including the company under the arbitration agreement reflects the mutual intention of all parties to the proceedings. This concept has been applied in a number of arbitrations (e.g. those carried out under the auspices of the International Chamber of Commerce) and has met the approval of some courts.

13. Courts have reached disparate decisions in those situations, often reflective of their general attitude towards arbitration. In many cases, courts have been able to hold the parties to their agreement, in some cases by using creative interpretations to achieve that result. For example, some courts have adopted a construction of article II of the New York Convention according to which the expression "an arbitral clause in a contract" should be read separately from the expression "arbitration agreements, signed by the parties or contained in an exchange of letters or telegrams". By parsing the provision in two limbs, the courts were able to liberalize the requirements of article II to enforce arbitration clauses contained in contracts that were not signed by both parties or were not contained in an exchange of letters or telegrams.

14. Apart from differing and not widely accepted interpretations of article II, it has been noted that, under existing case law, an arbitration clause that is contained in a writing (e.g. in a contract offer or in a sales or purchase confirmation) will meet the form requirement of article II(2) of the New York Convention only if: *(a)* the writing is signed by both parties; *(b)* a duplicate of the writing is returned, whether signed or not; or *(c)* the writing is accepted by means of returning another written communication to the party who sent the first writing. It has been frequently observed that these requirements are too restrictive and no longer in accord with international trade practices. There have been various cases where arbitration agreements were denied effect in court proceedings because the facts of the case could not be brought within the confines of article II(2) of the Convention. Furthermore, it could be imagined that in many cases arbitration was not even attempted because of the narrowness of the definition.

15. The factual situations set out above in paragraph 12 may be viewed, on analysis, as deriving from different underlying issues. The situations *(a)* to *(h)* are those where the parties have entered into a contract containing an arbitration clause but the form of that clause does not meet the statutory requirement. To the extent these situations give rise to undesirable results they should be addressed by broadening the statutory form requirement.

16. The situations in *(i)* to *(m)* are different in that in those situations it may be assumed that the arbitration agreement has been validly entered into by one set of parties, and the question is whether that arbitration agreement has become binding on a third party who later becomes party to the contract or assumes certain rights and obligations arising out of the contract. Jurisdictions have taken different approaches to third party rights and to the devolution of rights and interests in contracts and may reach different results. For example, whilst some jurisdictions are moving towards an acceptance of the group of companies theory, others have rejected it. These differences, rooted in the law of contracts, suggest that, if situations referred to in *(i)* to *(m)* require a modification of legislative provisions, the solutions should not interfere with the law governing the transfer of contractual rights and obligations to third parties.

Possible legislative approaches

17. One possible means of solving the above-mentioned difficulties would be to modernize the New York Convention in respect of the form of the arbitration agreement. When the Commission discussed this issue, various views were expressed as to the means through which modernization of the New York Convention could be sought (A/54/17, paras. 344 and 347). One view was that the issues related to the form of the arbitration clause should be dealt with by way of an additional protocol to the New York Convention. It was explained that redrafting, or promoting uniform interpretation of, article II (2) could only be achieved with the required level of authority through treaty provisions similar in nature to those of the New York Convention. While support was expressed for that view, concern was expressed that any attempt to revise the New York Convention might jeopardize the excellent results reached over 40 years of international recognition and enforcement of foreign arbitral awards through worldwide acceptance of that Convention. In response to that concern, however, it was pointed out that the very success of the New York Convention and its establishment as a world standard should make it possible for UNCITRAL to undertake a limited overhaul of the text if such work was needed to adapt its provisions to changing business realities, and to maintain or restore its central status in the field of international commercial arbitration.

18. Another possibility might be to prepare a convention separate from the New York Convention to deal with those situations which arise outside the sphere of application of the New York Convention, including situations where the arbitration agreement fails to meet the form requirement established in article II. When the Commission discussed this possibility (A/54/17, para. 349), some support was expressed for it. Another view, however, was that experience indicated that the process of adopting and securing widespread ratification of a new convention could take many years, and that meanwhile there would be an undesirable lack of uniformity. It was also stated that the suggested approach might be particularly suitable to deal with a number of the above-mentioned specific fact situations that posed serious problems under the New York Convention. However, with respect to some of those situations (e.g. transfer of rights or obligations to non-signing third parties), it was widely felt that the issues at stake went to general questions regarding the substance and validity of the underlying transaction. Accordingly, doubts were expressed as to whether it would be desirable and feasible to attempt to deal with those issues in the context of a set of provisions geared primarily to the form of the arbitration agreement.

19. A further possibility would be to rely on the UNCITRAL Model Law on International Commercial Arbitration as a tool for interpreting the New York Convention. Such a solution would improve the situation in that, for example, article 7(2) of the Model Law would be used to clarify the effect of a reference in a contract to a document containing an arbitration clause and to recognize the effect of using electronic means of telecommunication for the conclusion of an arbitration agreement. However, the requirement that the arbitration agreement be contained "in an exchange of" messages, which has caused difficulties in practice, would require amendments to the current text of the Model Law. Should the Model Law be amended, a range of possible approaches might be considered (see below, paras. 29-32).

20. In considering the possibility of amending the Model Law as a tool for interpreting article II(2) of the New York Convention (without amending the Convention), the Working Group may wish to consider also that national legislation may operate in the context of the more-favourable-law provision of article VII of the Convention. According to article VII(1),

> "1. The provisions of the present Convention shall not [...] deprive any interested party of any right he may have to avail himself of an arbitral award in the manner and to the extent allowed by the law or the treaties of the country where such award is sought to be relied upon".

21. Pursuant to this article, it may be considered that, if the law of the country where the award is to be enforced (or the law applicable to the arbitration agreement) contains a less stringent form requirement than the Convention, the interested party may rely on that national law. That understanding would be in line with the purpose of the Convention, which is to facilitate recognition and enforcement of foreign awards. That purpose is achieved by removing conditions for recognition and enforcement in national laws that are more stringent than the conditions in the Convention, while leaving to operate any national provisions that give special or more favourable rights to a party seeking to avail itself of an award.

22. It should be noted, however, that the acceptability of allowing less restrictive form requirements to operate through article VII(1) of the Convention would depend on whether article II(2) of the Convention is regarded as establishing a maximum requirement of form (thus leaving States free to adopt a less stringent requirement) or whether the Convention is interpreted as providing a unified form requirement with which arbitration agreements must comply with under the Convention. Furthermore, it should be noted, that according to some views, article VII(1) may be invoked to recognize more favourable national provisions on form only if the enforcement mechanism of the New York Convention is replaced by the national law on enforcement of foreign arbitral awards (whether provided by a statute or developed by case law). It is said that only if such a national enforcement regime exists, that regime can, through article VII(1), be used in lieu of the regime of the Convention. The Working Group may wish to discuss the validity and implications if these considerations. It may also wish to discuss whether these considerations relating to article VII should be taken into account in drafting possible amendments to the Model Law so as to establish a regime that will operate in harmony with the New York Convention.

23. When the Commission considered the possibility of preparing model legislation with a view to superseding article II of the New York Convention by relying on article VII of the Convention (A/54/17, para. 348), it was suggested to establish (in addition to model legislation) guide-

lines or other non-binding material to be used by courts as guidance from the international community in the application of the New York Convention. It was also suggested that any model legislation that might be prepared with respect to the form of the arbitration agreement might include a provision along the lines of article 7 of the United Nations Convention on Contracts for the International Sale of Goods, which is designed to facilitate interpretation by reference to internationally accepted principles. Similar provisions were included in the UNCITRAL Model Law on Electronic Commerce[2] and the UNCITRAL Model Law on Cross-Border Insolvency.[3] Such a non-binding commentary formulated by the Commission along with the model legislative provision could speed up the process of harmonization of law and its interpretation.

Possible content of uniform provisions

24. In considering the content of uniform legislative provisions, one possible approach, in line with recent legislative developments in a number of countries, would be to include a list of instruments or factual situations where arbitration agreements would be validated despite the lack of an exchange of documents. Such a list might be formulated so as to encompass the use of instruments and situations listed above in paragraph 12. While such a specific approach has the advantage of providing a clear and specific solution to the identified problems, it runs the risk that the provisions would not cover all situations that should be covered and may not adequately address developing business needs and practice.

25. A somewhat broader solution would be to validate written arbitration agreements even if they were not entered into by an exchange of documents. Language might be considered along the lines of a proposal made during the preparation of article 7(2) of the Model Law. The proposed language was as follows:

> "However, an arbitration agreement also exists where one party to a contract refers in its written offer, counter-offer or contract confirmation to general conditions, or uses a contract form or standard contract, containing an arbitration clause and the other party does not object, provided that the applicable law recognizes formation of contracts in such manner".[4]

While the proposal was at that time rejected "since it raised difficult problems of interpretation",[5] it may be considered that the idea underlying it remains valid.

26. During the preparation of the Model Law, in the written comments by Governments on the draft Model Law, a proposal was made (by Norway) in which it was observed that arbitration clauses are frequently found in bills of lading, which are usually not signed by the shipper. Nevertheless, it was said, such clauses are generally considered binding on the shipper and subsequent holders of the bill of lading. In order to clarify the status of such arbitration agreements a wording was proposed which addressed bills of lading as well as other written arbitration agreements signed by one party only. The proposal was to add to article 7 of the Model Law the following:

> "If a bill of lading or another document, signed by only one of the parties, gives sufficient evidence of a contract, an arbitration clause in the document, or a reference in the document to another document containing an arbitration clause, shall be considered to be an agreement in writing."[6]

27. The proposal was considered during the eighteenth session of the Commission in 1985, at which the Model Law was finalized.[7] While the proposal was ultimately not adopted, it was noted in the discussion that a substantial number of speakers had commented favourably on it.[8]

28. Various recently enacted national laws have provided for a wider definition than that included in the UNCITRAL Model Law. They are reproduced here as examples in order to stimulate discussion and possibly to be used as an inspiration in finding acceptable harmonized solutions.

29. In Switzerland, article 178 of the Federal Act of Private International Law takes a general approach:

> "1. As regards its form, the arbitration agreement shall be valid if made in writing, by telegram, telex, telecopier or any other means of communication which permits it to be evidenced by a text.
>
> "2. As regards its substance, the arbitration agreement shall be valid if it conforms either to the law chosen by the parties, or to the law governing the subject-matter of the dispute, in particular the law governing the main contract, or if it conforms to Swiss law."

30. In the Netherlands, article 1021 of the Arbitration Act 1986 provides:

> "The arbitration agreement shall be proven by an instrument in writing. For this purpose an instrument in writing which provides for arbitration or which refers to standard conditions providing for arbitration is sufficient, provided that this instrument is expressly or impliedly accepted by or on behalf of the other party."

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[2]Article 3:

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

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

[3]Article 8:

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

[4]Document A/CN.9/WG.II/WP.37, draft article 3, reproduced in the *UNCITRAL Yearbook*, vol. XIV: 1983, part two, III, B. 1.

[5]Document A/CN.9/232, para. 45, reproduced in the *UNCITRAL Yearbook*, vol. XIV: 1983, part two, III, A.

[6]Document A/CN.9/263 (Analytical compilation of comments by Governments and international organizations on the draft text of a model law on international commercial arbitration), comments on article 7, para. 5 (Norway), reproduced in the *UNCITRAL Yearbook*, vol. XVI: 1985, part two, I, A.

[7]Summary records of the United Nations Commission on International Trade Law for meetings devoted to the preparation of the UNCITRAL Model Law on International Commercial Arbitration, 311th meeting, reproduced in the *UNCITRAL Yearbook*, vol. XVI: 1985, part three, II.

[8]Ibid., para. 48.

31. A somewhat more detailed approach has been taken by the German Arbitration Law of 1997; section 1031 provides:

"(1) The arbitration agreement shall be contained either in a document signed by the parties or in an exchange of letters, telefaxes, telegrams or other means of telecommunication which provide a record of the agreement.

"(2) The form requirement of subsection 1 shall be deemed to have been complied with if the arbitration agreement is contained in a document transmitted from one party to the other party or by a third party to both parties and—if no objection was raised in good time—the contents of such document are considered to be part of the contract in accordance with common usage.

"(3) The reference in a contract complying with the form requirements of subsection 1 or 2 to a document containing an arbitration clause constitutes an arbitration agreement provided that the reference is such as to make that clause part of the contract.

"(4) An arbitration agreement is also concluded by the issuance of a bill of lading, if the latter contains an express reference to an arbitration clause in a charter party.

"(5) Arbitration agreements to which a consumer is a party must be contained in a document which has been personally signed by the parties. No agreements other than those referring to the arbitral proceedings may be contained in such a document; this shall not apply in the case of a notarial certification. A consumer is a natural person who, in respect of the transaction in dispute, is acting for a purpose which can be regarded as being outside his trade or self-employed profession *('gewerbliche oder selbständige berufliche Tätigkeit').*

"(6) Any non-compliance with the form requirements is cured by entering into argument on the substance of the dispute in the arbitral proceedings."

32. A detailed approach has been taken in England, where Section 5 of the Arbitration Act 1996 provides:

"[...]

"(2) There is an agreement in writing:

(a) if the agreement is made in writing (whether or not it is signed by the parties),

(b) if the agreement is made by exchange of communications in writing, or

(c) if the agreement is evidenced in writing.

"(3) Where parties agree otherwise than in writing by reference to terms which are in writing, they make an agreement in writing.

"(4) An agreement is evidenced in writing if an agreement made otherwise than in writing is recorded by one of the parties, or by a third party, with the authority of the parties to the agreement.

"(5) An exchange of written submissions in arbitral or legal proceedings in which the existence of an agreement otherwise than in writing is alleged by one party against another party and not denied by the other party in his response constitutes as between those parties an agreement in writing to the effect alleged.

"(6) References in this Part to anything being written or in writing include its being recorded by any means."

A non-legislative approach

33. Bearing in mind the various considerations underlying the preparation of a treaty or model legislation, including the long process of the legislative implementation of any solution that may be agreed upon, the Working Group may wish to discuss the advisability of preparing a non-legislative text. When the Commission discussed the question of the degree to which the current statutory provisions are regarded as outdated (A/54/17, para. 344), the view was expressed that, in the majority of cases, parties had no difficulty in complying with the current form requirements for arbitration agreements. It was also said that those requirements compelled the parties to consider carefully the exclusion of court jurisdiction. Therefore, it was suggested that if any work should be undertaken, it should be limited to the formulation of a practice guide. However, while that view received some support, the Commission decided that future work was necessary with respect to matters arising in connection with article II(2) of the New York Convention, and that legislative work was among the options to be considered.

34. In light of those considerations, the Working Group may wish to discuss the advisability of preparing practice guidelines or notes to alert parties in international transactions that in certain factual circumstances (such as those referred to above in para. 12) form problems might arise that might adversely affect the application of the New York Convention with respect to recognition of agreements to arbitrate and enforcement of arbitral awards. Such guidelines might be useful, for example, to warn trade organizations that sponsor standard forms that those forms may not meet the written form requirements, and the guidelines might propose changes in wording or practices to avoid such difficulties. In addition, such guidelines or notes might be useful to parties and judges of national courts in analysing whether the written form requirement has or has not been met by various types of business conduct. The Working Group might consider whether such guidelines or notes could be useful to international business as an interim or separate solution, while consideration is being given to the more time-consuming and complex process of drafting and implementing legislative solutions.

C. Arbitration agreement "in writing" and electronic commerce

35. The question as to whether electronic commerce is an acceptable means of concluding valid arbitration agreements should pose no more problems than have been created by the increased use of telex and subsequently of

telecopy or facsimile. The above-cited article 7(2) of the UNCITRAL Model Law expressly validates the use of any means of telecommunication "which provides a record of the agreement", a wording which would cover telecopy or facsimile messages as well as most common uses of electronic mail or electronic data interchange (EDI) messaging.

36. As to the New York Convention, it is generally accepted that the expression in article II(2) "contained in an exchange of letters or telegrams" should be interpreted broadly to include other means of communication, particularly telex (to which facsimile could nowadays be added). The same teleological interpretation[9] could be extended to cover electronic commerce. Such an extension of article II to cover certain means of communication that were not contemplated at the time the Convention was drafted would be in line with the decision taken by the Commission when it adopted the UNCITRAL Model Law on Electronic Commerce with its Guide to Enactment in 1996. The Guide, which was drafted with the New York Convention and other international instruments in mind, provides that

> "the Model Law [on Electronic Commerce] may be useful in certain cases as a tool for interpreting existing international conventions and other international instruments that create legal obstacles to the use of electronic commerce for example by prescribing that certain documents or contractual clauses be made in written form. As between those States parties to such international instruments, the adoption of the Model Law as a rule of interpretation might provide the means to recognize the use of electronic commerce and obviate the need to negotiate a protocol to the international instrument involved." *(Guide to Enactment of the UNCITRAL Model Law on Electronic Commerce,* para. 6.)

37. The Working Group may wish to discuss whether the interpretation of article II(2) of the New York Convention as covering also contracts and arbitration agreements entered into in the context of electronic commerce (either by reference to article 7(2) of the UNCITRAL Model Law on Arbitration or to the UNCITRAL Model Law on Electronic Commerce) can count on wide international consensus and whether it should be recommended by the Commission as a workable solution.

38. The Working Group, when it considers how legislation on modern means of communication influences the interpretation of article II(2) of the New York Convention, may wish to bear in mind the general issue of compatibility of electronic commerce with the legal regime established by a series of international conventions, governing different areas of trade, that contain mandatory requirements for the use of written documents. Repeated observations have been made that many treaties governing international trade do not satisfactorily accommodate the reality of electronic commerce and that under those treaties electronic messages remain potentially unacceptable as legal means of communication. An inventory of such treaties has been prepared by the United Nations Economic Commission for Europe (document Trade/WP.4/R.1096, 1994, as revised in 1999). In connection with that inventory, the Centre for the Facilitation of Procedures and Practices for Administration, Commerce and Transport (CEFACT) of the United Nations Economic Commission for Europe adopted the "Recommendation to UNCITRAL regarding implementing electronic equivalents to 'writing', 'signature' and 'document' in conventions and agreements relating to international trade".[10] In the Recommendation, the Centre:

> "*Being aware* of the need to avoid disadvantage to electronic commerce and support efforts to achieve global parity in law between manual and electronic commerce,
>
> "*Recommends* that UNCITRAL consider the actions necessary to ensure that references to 'writing', 'signature' and 'document' in conventions and agreements relating to international trade allow for electronic equivalents."

39. The Recommendation was noted by the Commission during its thirty-second session, together with some other issues in electronic commerce that might be put on the agenda (A/54/17, paras. 315-318). In connection with the Recommendation, support was expressed for the preparation of an omnibus protocol to amend multilateral treaty regimes to facilitate the increased use of electronic commerce (ibid., para. 316). It was decided that, upon completing its current task, namely, the preparation of draft uniform rules on electronic signatures, the Working Group on Electronic Commerce would be expected, in the context of its general advisory function regarding the issues of electronic commerce, to examine some or all of the possible items for future work, with a view to making more specific proposals for future work by the Commission (ibid., para. 318). In the light of that, it is suggested that considerations of the Working Group on Arbitration concerning the treatment of electronic messages in the context of the New York Convention will be helpful to the Working Group on Electronic Commerce and the Commission when they consider and take decisions on the general issue of compatibility of electronic commerce with international conventions; it is further suggested that any decisions taken in the Working Group on Arbitration on this matter should be in line with decisions taken on the general issue by the Working Group on Electronic Commerce and the Commission.

40. Finally, the Working Group may wish to note that, assuming that electronic messages are to be treated as written messages in the context of article II of the New York Convention, some of the practices developing in electronic commerce (over the Internet or otherwise) may lead to

[9]For example, the Swiss Federal Tribunal observed that "[article II(2)] must be interpreted in the light of [the Model Law], whose authors wished to adapt the legal regime of the New York Convention to current needs, without modifying [the actual Convention]". *Compagnie de Navigation et Transports S.A. v. MSC (Mediterranean Shipping Company) S.A.* 16 January 1995, 1st civil division of the Swiss Federal Tribunal; relevant excerpts in (1995) 13, Association suisse de lst arbitrage, Bulletin, pp. 503-511 at p. 508.

[10]The Recommendation, dated 26 February 1999, published under the symbol TRADE/CEFACT/1999/CRP.7, was unanimously approved by the plenary of CEFACT (document TRADE/CEFACT/1999/19 of 14 June 1999, para. 60).

difficulties that are connected with the requirement, discussed earlier, that an arbitration agreement be contained "in an exchange of" messages. Namely, it has been observed that electronic commerce may make it less likely for there to be an exchange of messages containing (or referring to) an arbitration agreement. The computerized connections between suppliers and buyers, which are being increasingly used, may lead to purchase orders being generated automatically (e.g. when the stocks of goods fall below a certain level). If these purchase orders are treated as "call-off" contracts that fall within an underlying agreement, no problem will arise since the arbitration agreement applicable to all the contracts will have been formed at the time of the underlying agreement, which will be regarded as performed whenever goods are shipped or services provided. If, however, these individual purchase orders are regarded on their facts as leading to a series of separate contracts, there may be no exchange of messages in relation to the arbitration agreement for each contract, with the consequent problems as set out above for any such contract. Such developments in electronic commerce may be regarded as one more argument underscoring the desirability of preparing modern rules on the form of arbitration agreements.

IV. SUMMARY AND CONCLUSION

41. The present document has been prepared to facilitate discussions in the Working Group on future harmonized solutions in the area of conciliation, enforcement of interim measures of protection and written form for arbitration agreements, as decided by the Commission (see document A/CN.9/WG.II/WP.108, para. 9). On the basis of considerations and decisions of the Working Group, the secretariat will prepare first drafts of uniform provisions with comments as appropriate for the thirty-third session of the Working Group, which, subject to approval by the Commission, will meet during the second half of 2000.

42. In addition to deliberating on topics discussed in this paper, the Working Group may wish, time permitting, to exchange views and information on other arbitration topics that were identified by the Commission as likely items of future work. Those topics are referred to in document A/CN.9/WG.II/WP.108, paragraph 6 and in paragraph 339 of the report of the Commission on the work of its thirty-second session (document A/54/17). With respect to those topics, the Commission left to the Working Group to decide on the time and manner of dealing with them.

V. POSSIBLE FUTURE WORK

A. Report of the Working Group on Insolvency Law on the work of its twenty-second session (Vienna, 6-17 December 1999)

(A/CN.9/469) [Original: English]

CONTENTS

INTRODUCTION

1. The Commission, at its thirty-second session (1999), had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law.[1] The proposal referred to recent regional and global financial crises and the work undertaken in international forums in response to those crises. Reports from those forums stressed the need to strengthen the international financial system in three areas—transparency; accountability; and management of international financial crises by domestic legal systems. According to those reports, strong insolvency and debtor-creditor regimes were an important means for preventing or limiting financial crises and for facilitating rapid and orderly workouts from excessive indebtedness. The proposal before the Commission recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that have expertise and interest in the law of insolvency, the Commission was an appropriate forum to put insolvency law on its agenda. The proposal urged that the Commission consider entrusting a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

[1] *Possible future work in the area of insolvency law: Proposal by Australia,* A/CN.9/462/Add.1.

2. The Commission expressed its appreciation for the proposal. It noted that different work projects had been undertaken by other international organizations such as the International Monetary Fund, the World Bank and the International Bar Association on the development of standards and principles for insolvency regimes. It noted that the broad objective of those organizations, while differing in scope and working methods as a consequence of their respective mandates and membership, was to modernize insolvency practices and laws. The initiatives taken in those organizations were proof of the necessity of assisting States to re-assess their insolvency laws and practices. Those various initiatives, however, were also in need of strengthened coordination, where appropriate, so as to avoid inefficient duplication of work and achieve consistent results.[2]

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

4. To facilitate that further study, the Commission was invited by the secretariat to consider the possibility of devoting one session of a working group to ascertaining what, in the current landscape of efforts, would be an appropriate product (such as a model law, model provisions, a set of principles or other text) and to defining the scope of the issues to be included in that product. Diverging views were expressed in response. One view was that more background work should be undertaken by the secretariat and presented to the Commission at its thirty-third session for a decision as to whether substantive work of elaborating a uniform law or another text of a recommendatory nature should be undertaken. Another view was that the question could be referred to one session of a working group, for the purpose of exploring those various issues, with a report to be made to the Commission at its thirty-third session in 2000 on the feasibility of undertaking work in the field of insolvency. At that time, the Commission would have before it sufficient information to make a final decision on that issue. It was emphasized that preparatory work for the session of the working group would require coordination with other international organizations already undertaking work in the area of insolvency law, since the results of their work would constitute important elements in the deliberations towards recommending to the Commission what it might usefully contribute in that area. It was pointed out that the importance and urgency of work on insolvency law had been identified in a number of international organizations and there was wide agreement that more work was required in order to foster the development and adoption of effective national corporate insolvency regimes.

5. The prevailing view in the Commission was that an exploratory session of a working group should be convened to prepare a feasibility proposal for consideration by the Commission at its thirty-third session. Subsequently, after the Commission had discussed its future work in the area of arbitration, it was decided that the Working Group on Insolvency Law would hold that exploratory session at Vienna from 6 to 17 December 1999.

6. The Working Group on Insolvency Law, which was composed of all the States members of the Commission, held its twenty-second session in Vienna from 6 to17 December 1999. The session was attended by representatives of the following States members of the Working Group: Australia, Austria, Brazil, Cameroon, China, Colombia, Egypt, Finland, Germany, Honduras, India, Iran (Islamic Republic of), Italy, Japan, Mexico, Russian Federation, Spain, Thailand, United Kingdom of Great Britain and Northern Ireland, United States of America and Uruguay.

7. The session was also attended by observers from the following States: Canada, Costa Rica, Gabon, Guatemala, Indonesia, Ireland, Kazakhstan, Lebanon, New Zealand, Pakistan, Poland, Republic of Korea, Saudi Arabia, Slovakia, Sweden, Switzerland and Ukraine.

8. The session was attended by observers from the following international organizations: International Monetary Fund (IMF), World Bank, Asian Development Bank (ADB), European Bank for Reconstruction and Development (EBRD), European Central Bank, Organisation for Economic Cooperation and Development (OECD), European Insolvency Practitioners Association (EIPA), International Bar Association (IBA), International Federation of Insolvency Professionals (INSOL), International Women's Insolvency & Restructuring Confederation (IWIRC) and The Group of Thirty.

9. The Working Group elected the following officers:

Chairman:	Mr. Wisit WISITSORA-AT (Thailand)
Vice-Chairman:	Mr. Paul HEATH (New Zealand, elected in his personal capacity)
Rapporteur:	Mr. Tuomas HUPLI (Finland)

10. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.V/WP.49) and Note by the secretariat on possible future work on insolvency law (A/CN.9/WG.V/WP.50).

11. The Working Group adopted the following agenda:

1. Election of officers.
2. Adoption of the Agenda.
3. Possible future work on insolvency law.
4. Other business.
5. Adoption of the report.

[2] *Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17* (A/54/17), paras. 381-385.

DELIBERATIONS AND DECISIONS

12. The Working Group discussed possible future work on insolvency law on the basis of the note prepared by the Secretariat (A/CN.9/WG.V/WP.50). The deliberations of the Working Group are set forth below, with the recommendation of the Working Group contained in para. 140. References to paragraph numbers in the headings of this paper are references to the text of A/CN.9/WG.V/WP.50.

A. General remarks

13. At the outset, the Working Group exchanged information on the background to the proposal for further work by the Commission. It was pointed out that there was widespread agreement that effective insolvency systems were a critical tool in forestalling and dealing with the financial difficulty of firms. In circumstances where the entire enterprise sector was in distress, an effective insolvency regime provided the necessary legal framework for the restructuring of corporate indebtedness and the necessary conditions for the resumption of growth and employment. It could create confidence in the credit system and, if designed with the appropriate incentives and safeguards, could provide a tool that was likely to be used by debtors early in financial difficulties, thus increasing the chances of successful rehabilitation.

14. The Working group exchanged views on current developments in regulatory issues related to insolvency. Various reports at the governmental, inter-governmental and non-governmental levels confirmed the importance being attached to insolvency law and insolvency law reform worldwide. It was reported that a number of countries had introduced recently, or were developing, legislation reforming their insolvency regimes, in some cases including provisions adopting, or based upon, the UNCITRAL Model Law on Cross-Border Insolvency. A number of international organizations were focusing upon insolvency issues and ways of developing effective and efficient insolvency regimes. The World Bank advised that it was working on the development of principles and guidelines addressing the legal, institutional and regulatory frameworks required for an effective insolvency regime. Those principles and guidelines were in the nature of core elements, rather than standards, and allowed flexibility to adapt to varying circumstances. They focused on a number of key aspects of debtor-creditor regimes, exploring the interplay between modern credit and security systems and insolvency, the process of corporate rescue through informal and formal channels, and specialized conditions such as systemic events, enterprise distress among State-owned enterprises and bank insolvencies. That work was being developed in cooperation with interested international organizations and through a series of regional conferences. Completion was scheduled for August 2000.

15. The Asian Development Bank (ADB) advised that its approach was narrower, being focused on studying 11 Asian countries, but it was aimed at the broad goal of encouraging the greater development of legal and commercial systems, practices and institutions for application in all economic circumstances (the ADB Report is referred to in A/CN.9/WG.V/WP.50). In particular, the future challenge for those countries was to strengthen corporate governance, one important part of which was insolvency law. The reform programme was being developed through a series of symposia, refining the issues for consideration and developing solutions. Recent symposia stressed the need for stronger contacts and cooperation between the judiciaries of the region, leading to proposals for judicial colloquia and education and training programmes. Completion of a final report was scheduled for early 2000.

16. The International Monetary Fund (IMF) referred to its staff report on insolvency systems (referred to in A/CN.9/WG.V/WP.50) and indicated that the report would be used by the Fund to provide a basis for its policy dialogue with, and technical assistance to, countries, with particular emphasis upon the analysis which resulted in the recommendations. The International Bar Association indicated that its Committee J was working on model substantive insolvency provisions, but that progress was slow due to the limited time available for the project.

17. On the question of possible future work by the Commission, it was suggested that the Commission could provide direct technical guidance on the substantive laws governing insolvency procedures and focus on how existing principles could be implemented through legislative action. However, the view was expressed that statutory language by itself was not sufficient to establish a functioning insolvency regime; what was required was a strong institutional structure that was both accountable and transparent. Nevertheless, it was pointed out that while it was clear that such legislative provisions could not of themselves address the very important issue of the knowledge and skills required of those administering and using insolvency regimes, they could facilitate the establishment of widely-shared knowledge and experience on the basis of a common foundation. Moreover, undertaking further work would serve to underline the continuing importance of insolvency regimes in all phases of the economic cycle, not just in periods of crisis. The benefits of modernizing and harmonizing even some part of the existing diversity of laws relevant to insolvency was also emphasized as an important benefit of possible future work by the Commission.

18. To maximize the likelihood of success, it was suggested that the precise scope of the work should be realistically targeted. To that end, the view was expressed that the work should address companies or incorporated bodies, not consumers. Certain institutions that were subject to special regulation and might require special treatment (such as financial institutions, insurance companies, certain utilities) and insolvency institutions or supervisors also might need to be excluded. In addition, it was suggested that in order to establish common concerns and views, specific topics should be identified to limit and define the scope of the work to be undertaken. One such topic proposed was that of out-of-court restructuring.

19. With respect to the form of any future work, reservations were widely expressed as to the possibility of formulating a universal or “one size fits all” model law on insol-

vency. In support of that view, the complexity and diversity of insolvency law and its integral relationship with a number of other similarly complex laws, such as those dealing with corporations, securities and regulation of the financial and insurance sectors, was stressed. It was suggested that what might be feasible was the development of a more flexible, soft law option such as key principles or legislative guidelines. Another suggestion, as a further step, was that the Commission could take such principles and show, where appropriate, how they could be developed into legislation. The integral connection between subject matter and form was also stressed, with the Working Group agreeing that no decision could be taken on the issue of form until questions of content had been discussed in detail.

20. The Working Group decided to continue its deliberations by engaging in a discussion of the key objectives of an insolvency regime, as outlined in the note of the secretariat (A/CN.9/WG.V/WP.50, paras. 24-31), before commencing a more detailed discussion of the core features.

B. Key objectives

21. As to objectives A ("Maximize value of assets") and B ("Strike a balance between liquidation and rehabilitation"), the Working Group generally agreed that there was a close connection between them and that what was required was a balance between different insolvency procedures. While the emphasis might be upon providing for maximum recovery by creditors, other goals such as encouraging the development of an entrepreneurial class and protecting employment could not be ignored. A further view was that those objectives also needed to take into consideration the loss of production capacity, the loss of the operational value of the entity and the possible disappearance of the debtor and the debtor's assets. The concern was expressed that, as drafted, the objectives should not be interpreted as polarizing insolvency into liquidation on the one hand and rehabilitation on the other. What was required was provision for a more broadly phrased "arrangement" or "method" which was aimed at maximizing the return and minimizing the effects of insolvency and would include the range of possible insolvency techniques. Such a formulation would also avoid any implied preference for one technique over another as a means of achieving objective A.

22. As to objective C ("Equitable treatment"), there was agreement in the Working Group with the general formulation, subject to clarification as to whether the reference to bargains struck between debtor and creditors properly took account of the interests of all creditors, especially where those interests might arise by the operation of law, not contract.

23. In terms of objective D ("Provide for timely, efficient and impartial resolution of insolvency"), there was general agreement in the Working Group on the benefits of establishing time limits in respect of certain matters, subject to those time limits being susceptible of modification, extension and reduction by the courts or other administering body. There was support for the view that achieving general agreement on what those specific time limits might be would be difficult. The need for an overall time limit for the proceedings as a whole was questioned. In addition to the reference to resolution of insolvencies quickly and efficiently, it was proposed that the objective should also provide for the commencement of the process in the same manner. Specific suggestions for amendment of the objective included broadening the reference to the "business" of the debtor to the "activities" of the debtor; including a reference to minimizing the cost of the proceedings in addition to timeliness and efficiency; changing the reference to "tribunals" to "organs or bodies"; and broadening the notion of supervision by courts and administrative bodies to include intervention and direction. A further suggestion was that while the first sentence properly stated the objective, the remainder of paragraph 28 stated what was really in the nature of a core feature of an insolvency regime.

24. Some concern was expressed as to what might constitute "premature" dismemberment in the context of objective E ("Prevent premature dismemberment of the debtor's assets by creditors"). Another concern expressed was that the reference to the stay should be qualified by including its purpose, such as that the stay be "of sufficient duration to enable proper examination of the debtor's situation", whether there might be exceptions to its application and modification and lifting of the stay. It was pointed out that those issues had successfully been addressed by the UNCITRAL Model Law on Cross-Border Insolvency which should serve as the standard. Furthermore, the stay should apply to enforcement measures against the debtor, but not necessarily to the commencement of <u>any</u> action against the debtor. A further suggestion was that the reference to orderly conduct of the proceedings was more properly associated with the references to efficiency in objective D and should be included there, rather than in objective E which should focus upon the stay. It was suggested that the stay of actions against the debtor should be complemented by prohibiting the debtor, subject to appropriate exceptions, from disposing of, or encumbering, its assets.

25. There was support for the view that objective F ("Provide for a procedure that is predictable and transparent and which contains incentives for gathering and dispensing information") should focus upon transparency and predictability; the elements of gathering and dispensing information should be considered in the context of core features, rather than key objectives. It was proposed that the objective needed to more clearly distinguish between the predictability of an outcome and transparency as it related to dealing with the flow of information which would lead to the outcome.

26. The Working Group endorsed the importance of objective G ("Establish a framework for cross-border insolvency") and adoption of the UNCITRAL Model Law on Cross-Border Insolvency as the means of satisfying the objective.

27. A number of other issues were identified as being key objectives of an insolvency regime. The first proposal was

the addition of an objective of early commencement of insolvency proceedings. In support it was pointed out that if the proceedings were to be successful, whether liquidation or rehabilitation, it was important to preserve the value of the debtor's assets. One means of facilitating that was to ensure that there were incentives to encourage management to commence proceedings while there was still value in the assets of the entity or, alternatively, to provide sanctions for failure to commence at an early stage.

28. A second proposal was related to objective F ("Provide for a procedure that is predictable and transparent and which contains incentives for gathering and dispensing information") and concerned adding a goal of transparency in relation to information about the debtor's situation. Since that was crucial to creditors, it was suggested that an insolvency law needed to contain incentives encouraging the debtor to reveal its position or sanctions for failure to do so.

29. A further proposal was for the addition of an objective to facilitate out-of-court workouts. The view was expressed that since the way in which the insolvency law was structured determined the context in which such a procedure might occur, it was important for the possibility of out-of-court workouts to be stated as a goal. It was also pointed out that there was a close connection between laws relating to the enforcement of debts, whether secured or not, and the effectiveness of insolvency laws and accordingly, that was an area which should be identified as requiring attention.

30. The issue of fraud was raised as being of general importance to an insolvency law, not just in the context of objective C ("Equitable treatment"). It was suggested that since fraud fell into a general category of acts detrimental to the insolvency procedure it could be included as a general objective under that description.

31. Having completed its consideration of key objectives, the Working Group continued its deliberations with identifying the core features of an insolvency regime.

C. Identification of core features

1. General remarks

32. The Working Group first considered the summary of questions to be resolved by an insolvency regime as indicated in pararaphs 32 and 33 of the note by the secretariat (A/CN.9/WG.V/WP.50). It was pointed out that a number of additional matters had been considered in the context of key objectives and should be added to any consideration of core features. Those included: acts detrimental to creditors; transparency; information to be provided by the debtor on its situation and the disclosure of that information to creditors. Other matters to be added for general consideration included: fraud; identification of assets of the debtor and treatment of third party assets; and protection and enfranchisement of creditor rights (that would include providing for access to information and ensuring that creditors had the right to act on their own behalf in insolvency proceedings when they had a stake in a particular issue, whether the proceedings were for liquidation or rehabilitation).

33. Several proposals were made for amendments and additions to paragraphs 32 and 33 as drafted. Those included under paragraph 32: amendment of item 3 to refer to the time at which proceedings "can or must" be commenced; addition of a reference to possible supervision of the debtor in addition to displacement in item 4; under item 5, inclusion of a reference to parties other than creditors whose actions may be stayed; and in item 8, addition of a reference to other issues dealing with the treatment of creditors. Under paragraph 33 the proposals included adding a reference to retention and compensation, as well as possible training, of professionals.

2. Discussion of core features

(a) Application of the law—individuals and enterprises (paras. 34-36)

34. Some concerns were expressed as to what was intended to be covered by the use of certain terminology. Use of the words "companies", "firms" and "financial institutions" raised questions of definition and it would need to be made clear exactly what was included within those terms.

35. The view was expressed that future work of the Commission should be limited to bodies corporate with a distinct legal personality. It was pointed out that if individuals and partnerships were to be included, difficulties with issues such as discharge and attachment of post-bankruptcy wages, as well as personal matters such as settlements in divorce proceedings, would arise. Another view was that if such enterprises were involved in trading activities, they should be included in the scope of work, since the focus of the Commission was upon the activity of trade. It was proposed that the focus should be upon the activity being conducted, that is trade, and the bodies through which that trade tended to be conducted. Such a formulation would accommodate the diversity of ways in which, and vehicles through which, trade was conducted worldwide.

36. With respect to highly regulated entities, such as banks and insurance companies, it was suggested that the opt-out provision of the UNCITRAL Model Law on Cross-Border Insolvency (article 1(2)) provided a good solution. An opposing view was that a simple exclusion of such entities ignored the current reality that some banking and insurance functions were commonly undertaken by general trading groups, which themselves should be included within the scope of further work.

37. With regard to State-owned enterprises, there was support for the view that there was no reason for a general exclusion from the application of an insolvency regime, although specific exclusions might be deemed necessary. Such an exclusion might include those State-owned enterprises subject to special regulation (such as a highly regulated, government-controlled utility), but not enterprises in which the State had only a partial interest or State-owned enterprises which were engaged in commercial activity.

(b) The relationship between liquidation and rehabilitation (paras. 37-46)

38. The Working Group generally agreed that what was required was a balance between different insolvency procedures, however they may be arranged in the insolvency law (such as unitary proceedings or otherwise). As noted in the discussion on key objectives, there should not be a polarization of proceedings into liquidation on the one hand and rehabilitation on the other, but the inclusion of a range of possible insolvency techniques that could be used to achieve the objective of maximizing the value of assets (see also paras. 90 and 91).

(c) Liquidation procedures (paras. 47-103)

39. As a preliminary point, it was suggested that the Working Group may need to clarify what was intended by the term "liquidation" and what steps might generally be agreed to be included within that term. It was suggested, for example, that some liquidation regimes did not contemplate the possibility that a debtor entity could continue to trade before being sold as a going concern.

40. A number of amendments and additions to the liquidation steps outlined in para. 47 were suggested. Those included: under item 3, that the independent person could also be an independent body which conducted and administered the liquidation; under item 4, the possibility of continuation of the business as an alternative to closure and possible authorization of the liquidator to continue the business for a limited purpose; a reference to possible conversion of liquidation to rehabilitation; and provision for the disclosure of information concerning the debtor's position including recent transfers, assets, debts etc.

Conditions for commencement of liquidation (paras. 48-52)

41. A number of views were expressed as to what should constitute the trigger for commencement of proceedings. Support was expressed for the general cessation of payments test, although there was some concern that that was too vague and subjective a standard. A further concern expressed was that general cessation of payments could be a symptom of extreme difficulty and thus defeat the goal of early commencement. One alternative suggestion was to adopt a liquidity test together with the balance sheet approach, which considered whether the value of debts and liabilities exceeded the value of assets and established a more objective test. Another suggestion was to assess a range of objective facts which might include cessation of important and sensitive payments such as rent, taxes, wages and social security payments, as well as other matters. In such a scenario, cessation of payments would be only one indicator of a need to commence insolvency proceedings and would require the individual circumstances of the debtor to be examined.

42. With respect to creditor commencement, the concern was expressed as to how a creditor could gain access to information that would indicate a general cessation of payments, rather than a simple failure to pay that particular creditor's claim. If that information could only be obtained through a complex procedure, it may not be an appropriate trigger. If, however, a simple failure to pay one creditor's claim was accepted as a commencement criterion (and one procedure outlined might involve using that single failure to establish a presumption of insolvency), it could raise other problems, such as the potential for that creditor to be able to disrupt out-of-court proceedings by commencing insolvency proceedings. An alternative view was that a quick procedure for creditor commencement was not necessarily hostile to the idea of rehabilitation as the debtor was in a position to know its own situation and could, at any time, itself take steps to initiate either liquidation or rehabilitation.

43. A related issue was whether a duty to commence proceedings should be established. It was suggested that in order to satisfy the objective of early filing, the insolvency law needed to include incentives (such as protection from enforcement actions) or sanctions for failure to file. It was recognized that not only was the choice between the so-called "carrot" or "stick" approach dependent upon individual countries' situations and how insolvency regimes dealt with out-of-court processes, but that also there was a danger that the establishment of an obligation might thwart the achievement of an out-of-court settlement.

Effect of commencement—assets of the estate (paras. 54-56)

44. An issue was raised as to how third party property should be treated—was it part of the estate or did it have some other status? One view was that while it did not necessarily form part of the estate, the estate might nevertheless be responsible for protecting that property. In such cases, it might be possible for that property to be used by the estate, pending a decision as to its purchase or return to the third party. In other cases, no reservation of title was recognized once property had been used by the debtor and such property would form part of the estate.

45. It was stressed that there was a difference between unified and other types of proceedings with respect to the treatment of property. In the case of the former, since the decision as to what constituted the assets of the estate would be delayed until the decision on which procedure should be followed, protection of the estate until that time would be required. In other cases, the type of procedure followed would indicate how the estate should be treated from an early stage.

Effect of commencement—protecting the estate (paras. 57-62)

46. It was stressed that the proceedings could be divided into distinct stages to which different considerations applied, such as the period between the time a petition was filed and granted and after the proceedings had opened. It was also clear that different types of proceedings would give rise to different considerations, for example where the estate was to be sold piecemeal, the need for protection of assets and restraint of creditors was not as crucial as where

the business was to be sold as a going concern or in cases of rehabilitation.

47. Two key issues identified for further consideration were the need to include secured creditors in any stay on rights of enforcement and the ability of the liquidator to obtain information relevant to preserving the assets.

The proceedings—verification of claims (para. 64)

48. There was general support for the view that the topic of verification of claims was perhaps understated as it could have a major impact upon the ability of creditors to participate in the process. It could also serve as a major point of delay in the proceedings if all claims were required to be approved before the next steps in the process could be taken. One solution to the problem would be to allow for provisional recognition of claims for certain temporary purposes, with the claim being fully verified for the purposes of distribution. A number of other relevant issues were raised, including questions of participation of foreign currency claims; contingent liabilities; general priority claims; the impact of multiple proceedings; timing of claims and whether claims could be forfeited if made outside stipulated times or simply deferred; and whether verification was necessarily always a task of the creditor or whether there might be circumstances where it was not required, such as where it was apparent from the debtor's books that a certain claim might exist.

Powers of avoidance (paras. 70-80)

49. A view expressed widely in the Working Group was that avoidance powers should be available for use in both liquidation and rehabilitation proceedings. A related view was that the powers should be the same in both processes, since otherwise the differences in the powers might be used by a creditor as a reason for choosing the procedure most likely to lead to an outcome favourable to that creditor, rather than the procedure most suited to resolving the debtor's financial difficulties. An alternative view was that the powers should not be the same for both types of proceedings as different considerations were raised and there should be, for example, some limitation to the power to nullify objectively normal transactions in the case of rehabilitation.

50. It was suggested that the powers should not be limited to addressing fraudulent transactions, but should more generally address transactions and transfers which prejudiced creditors generally. It was stressed that that was a difficult area to regulate since the types of transactions being addressed were not generally admitted by the debtor and therefore were not necessarily readily apparent to the liquidator. In terms of the manner in which different transactions might be covered, it was suggested that some specified types of transactions, such as related-party or insider transactions, could be presumed to be prejudicial (so that the liquidator would not have to prove prejudice), while for other transactions prejudice would have to be demonstrated. In the second class of transaction, the demonstration of prejudice could be subject to challenge. It was pointed out that there might be difficulties with a general concept of what might constitute an insider transaction since national laws varied considerably on this point.

51. As to the period of suspicion, it was suggested that setting a time limit would be important, but that in principle it should not be too long as that might create insecurity. Another view was that the imposition of time limits might cause a debtor to delay commencing proceedings in order to ensure that certain transactions would fall outside the specified period of suspicion.

Treatment of contracts (paras. 81-88)

52. The view was widely expressed that, like avoidance powers, the power to continue or terminate contracts was essential to both liquidation proceedings, especially where the business was to be sold as a going concern, and rehabilitation proceedings. The choice between termination or continuation of a particular contract would be dependent upon which course of action was most profitable for the creditors. It was noted in this regard that variation of contracts, particularly termination, could have a negative financial impact upon the estate because of the need to pay compensation for termination and potentially adversely affect the success of a rehabilitation. The need for those powers in rehabilitation cases was explained as being essential to address the common situation that creditors could not expect to be fully paid, but would nevertheless receive more than they would have if the entity had been liquidated. Since full payment could not be achieved, the debtor was likely to have to breach a number of contracts which would result in the need to pay compensation; that compensation would be achieved by the less than complete payment of the debt.

53. It was noted that some types of contracts, such as labour contracts, might need to be stated as exceptions to those powers, but the benefits to be achieved by those exceptions would have to be balanced against the goal of maximization of value.

Set-off (paras. 89-91)

54. The view was expressed in the Working Group that, notwithstanding that set-off was not always permitted under national law, as a general principle it should be recognized. Another view was that while such recognition might be appropriate in the case of a pre-commencement right to set-off, that recognition could not be supported with respect to post-commencement set-off, although there might be exceptions. It was generally considered that netting arrangements (multilateral compensation schemes for financial obligations) should be recognized. It was pointed out that in some jurisdictions the right to set-off was treated in the same way as a right to security. It was suggested that if a set-off was treated as a secured claim and subjected to the stay on enforcement of rights it would give the liquidator the opportunity to address some of the social policy issues that might arise in insolvency proceedings. Another view was that permitting set-off was an exception to the equitable treatment of creditors and, in some jurisdictions, may contradict national laws, such as provisions on non-payment of wages.

Disposition of assets (paras. 92 and 93)

55. It was questioned whether court or creditor approval was necessary for disposition of assets. One view was that such a requirement could unnecessarily delay the proceedings, risk reducing the value of the assets and prove to be costly. That was particularly the case where the assets to be sold were perishable and required rapid sale in order to maximize their value. It was noted that in some jurisdictions liquidators were given special powers with regard to such assets. A better means of ensuring that the disposition was conducted fairly and impropriety avoided was to rely upon provisions dealing with the liability of the liquidator and the appeal or dispute procedures available to the creditors. Another view was that the experience in some jurisdictions where creditor approval was required did not show that the requirement for approval gave rise to problems; rather there were more likely to be problems with one person controlling the efficacy of the sale. Provided creditors were closely involved in the liquidation procedure and were represented by creditor committees, obtaining approval for sale of assets was not likely to cause delay to the sale process.

56. On the question of notice, one view was that the giving of notice avoided any suggestion of collusion, allowed the liquidator to get a better price since the sale would be more likely not to be the subject of a single bid and would assist in avoiding any suggestion that the assets had not been exposed sufficiently to the market.

Priorities (paras. 94-100)

57. It was reported to the Working Group that recent work on the issue of priorities had resulted in a number of recommendations which might be relevant to the consideration of that issue. The general principle was that after payment of secured creditors, the proceeds of realization of property should be distributed equally and without preferences to the remaining creditors, unless there were compelling reasons to justify giving preferential status to a particular debt. Policy factors which might be taken into account in determining whether compelling reasons existed to grant preferential status might include: existing policy factors arising under other laws outside the insolvency framework, including international obligations such as those relating to employees; the balancing of private rights should generally have priority over public interests; the need to create incentives for creditors to manage credit efficiently; the desirability of encouraging those who make credit available to fix the price of credit as low as possible; fine distinctions should be not be drawn between classes of creditors causing one class to bear a greater burden of unpaid debt; and the impact which a preferential debt would have upon transaction or compliance costs. Three tests were suggested for determining what would constitute a "compelling" interest: whether it was justified by fairness and equity; whether it intruded unnecessarily on the law as it affected property rights and securities; and whether it provided encouragement for the effective administration of insolvency, or at least did not provide disincentives to administer insolvent estates efficiently. Consideration should be given to whether social imperatives could be met in ways other than by establishing preferences in insolvency, but where public interest grounds were found to be justified they should be articulated clearly to promote transparency in the insolvency process.

58. While there was some agreement that preferences generally should be avoided or kept to a minimum, there was also support for establishing priorities for employee claims and, in some cases, government claims such as tax. It was suggested that those issues were very closely connected with national social imperatives and might involve different rationales in different countries. It was generally agreed that it would be very difficult to reach agreement on the ranking of priorities but that, as a matter of principle, priorities should not be allowed to overwhelm the insolvency process, that other ways of dealing with the same social imperatives should be encouraged and that transparency was a desirable goal. A further suggestion was that consistency of approach should be encouraged so that different priority regimes were not established for different processes within a single insolvency law.

Discharge (paras. 101 and 102)

59. As a preliminary point, it was noted that the relevance of the topic would depend upon the scope of any future work on insolvency and the debtors to be covered, as well as the way in which the relationship between principal and corporate entities and their directors for the purposes of guarantees and ongoing liability for debts might be treated. It was suggested that, since some countries' trade activities were often carried out by individuals rather than limited liability corporations, the value of any future work might be affected if it excluded types of entities that might not be corporate bodies, but which were nevertheless involved in significant numbers in trade in certain countries. It was also noted that where discharge raised issues of social policy it might be difficult to reach a generally agreed approach; one particular concern was noted in respect of those jurisdictions where bankruptcy carried with it significant social stigma.

60. It was pointed out that the treatment of the topic in paragraphs 101 and 102 did not clearly distinguish between discharge of the debtor from debts and discharge from bankruptcy. The view was expressed that where there was fraudulent behaviour by the debtor, the proper remedy would be to pursue the fraud under appropriate criminal sanctions rather than to adopt the approach of not discharging the debtor from bankruptcy. While it might also be possible to suspend discharge in respect of those debts procured by fraud, it would be necessary to distinguish between those acts which would justify only partial refusal to discharge debts and those where complete denial of discharge would be justified.

Foreign creditors (para. 103)

61. While it was generally agreed that foreign creditors should be treated in the same way as domestic creditors, it was noted that for purposes of notification it might be necessary to set different time limits and conditions for foreign creditors. This was an issue which had been

discussed in deliberations on the UNCITRAL Model Law on Cross-Border Insolvency and resulted in agreement on special notice provisions for foreign creditors under article 14 to address their particular situation.

Additional topics possibly to be considered

62. A number of additional issues were suggested for inclusion as core features of an insolvency regime. These included: the effect of insolvency on transactions occurring after commencement but before notice of the proceedings; powers and duties of the liquidator, as well as supervision, replacement and remuneration; remedies of creditors, in particular as regards disputing claims by other creditors; treatment of non-monetary claims and claims that were not yet due when the proceedings were opened; the transparency and fairness of procedures; the effect of insolvency proceedings on other pending proceedings; and insolvency of multinationals. The view was expressed that the issue of notice and its effects was generally crucial to insolvency proceedings and could perhaps be included as a separate core feature or objective. Provision of notice to creditors was essential to their participation in the process and to the presentation of claims. The Working Group exchanged views on the ways in which notice might be given, in respect to commencement of proceedings as well as other stages of the proceedings.

(d) Rehabilitation (paras. 104-143)

Essential features (para. 104)

63. A number of issues were suggested for addition to the essential features of rehabilitation proceedings set forth in paragraphs 104 of the note by the secretariat (A/CN.9/WG.V/WP.50). Those included: failure of rehabilitation and conversion to liquidation, including the costs of an attempted rehabilitation and how they were to be dealt with in a subsequent liquidation; determination of the appropriate relationship between the debtor's creditors and the debtor's owners (including the continuing involvement of the owners in the entity), especially where the owners were also creditors; and the extent to which rehabilitation raised public interest issues, such as those of the local community.

64. A question was raised as to the voluntary nature of rehabilitation proceedings and whether what was intended was that the debtor's acceptance of a rehabilitation plan was to be voluntary or that the initiation of the proceedings by the debtor was to be voluntary. While it was suggested that voluntary proceedings would require the debtor to agree to commencement, it was observed that a number of jurisdictions included provisions for rehabilitation proceedings that could be imposed upon the debtor. In terms of initiation of proceedings, it was agreed that both creditors and debtors should be able to commence rehabilitation proceedings.

Commencement requirements (paras. 105-110)

65. On the question of the commencement criterion, one view was that the same test should apply to both liquidation and rehabilitation, whether that test be general cessation of payments or some other test. It was also noted, however, that the goal of early commencement suggested a test other than general cessation of payments might be more appropriate, at least in the case of debtor-initiated proceedings. Prospective illiquidity was proposed, a test that would enable a debtor to anticipate financial crisis and use the rehabilitation process to work its way out of financial difficulty, a goal consistent with key objectives agreed by the Working Group. It was suggested that prospective illiquidity might cover cases such as those where the debtor was facing the prospect of a large and successful tort liability claim. A further view, however, stressed that what was needed was a test which was sufficiently flexible to be applicable in different cases. One possibility along those lines might be not to apply a commencement test at all, provided that there were safeguards against abuse of the process; it was suggested that sometimes rehabilitation was commenced to delay the inevitable and consume what little funds were left to the debtor. One means of addressing that problem might be to provide for some type of early assessment of the debtor (which might be undertaken, for example, by the court or an independent expert) to determine which of several possible processes might work for that debtor, noting that rehabilitation was not a single process but a hierarchy of processes which ranged from a simple moratorium to complete restructuring. It was noted with respect to an assessment procedure that it might prove to be costly and delay proceedings unnecessarily. Other approaches involved creditors in the process and required them to vote on the feasibility of the rehabilitation plan within a limited time frame or required that proof of bona fides be made to the courts. The Working Group exchanged examples of different rehabilitation procedures and commencement criteria that were applicable under different national laws.

The stay (para. 112)

66. The Working Group generally agreed on the importance to rehabilitation proceedings of a stay on rights of enforcement and that it should apply universally to all creditors. A number of issues were discussed in relation to the questions of to whom the stay should apply; whether it should apply automatically or by the discretion of the court; the period of its application; and relief from the stay.

67. In terms of the universality of the stay, it was noted that a universal approach avoided any dispute as to which securities would be essential to the business and which would not. It was observed, however, that certain types of security might not need to be included within the stay and could benefit from exclusion from the stay. A related issue was whether the right of the debtor to dispose of or encumber its assets should also be stayed to preserve the estate, but doubt was expressed as to whether that step really would be necessary to rehabilitate the debtor.

68. As to the automatic application of the stay, opinion was divided. It was noted that not all jurisdictions provided for an automatic stay, one rationale for that approach emphasizing that part of the creditor's bargain with the debtor was likely to be prompt enforcement of the debt with no

interference. In terms of avoiding litigation through automatic application of the stay, it was observed that automatic stays were likely to give rise to applications to the court for modification, while stays which were discretionary were likely to give rise to litigation seeking their application by the court. Neither type of stay was more likely to reduce the possibility of litigation than the other; there would be a cost associated with either applying or lifting the stay in either case. In response, it was observed that while both types of stay might give rise to litigation, the litigation would occur at different stages of the proceedings. The advantage of an automatic stay was that it could be in place at the commencement of proceedings and was therefore of immediate benefit to the administrator and to the estate. It was suggested that results similar to those arising from the application of a stay (irrespective of whether it was automatic or discretionary) could be achieved by applying other techniques; requiring the debtor to negotiate with creditors, for example, would be a good test of the viability and feasibility of the rehabilitation plan and a credible plan would probably gain secured creditor's approval. In such a case, the absence of a stay on the claims of secured creditors might not undermine the process.

69. It was generally agreed that the provision of relief from the stay (e.g. its total or partial lifting or restriction) was an important issue. As to duration of the stay, it was emphasized that an indefinite stay could adversely affect secured creditors and the value of the securities. Since the stay might only be required to allow certain steps in the process to occur, it need only be of temporary application. That concern was closely related to one of the key objectives discussed by the Working Group, that of timely and efficient resolution of proceedings. Accordingly, it might be appropriate to impose deadlines for preparation of the plan so that the stay would be of limited duration. A further issue was whether relating the duration of the stay to the size and complexity of the rehabilitation proceedings might be an appropriate approach.

Control of the debtor's business (paras. 113-116)

70. It was a widely expressed view that no general, inflexible rule could be agreed on the issue of control of the debtor's business during the rehabilitation proceedings. One suggestion was that there were a number of cases where the situation of the debtor could not be attributed to mismanagement or misappropriation on the part of the debtor and there was, therefore, no compelling reason to remove the management responsibilities. An alternative view was that since management was responsible for the financial difficulties of the debtor, the business should be completely removed from management control and replaced by an administrator. In other cases, even where there was mismanagement, the technical nature of the business might require close and continuing involvement of the former management to ensure the efficient functioning of the debtor on a day to day basis, even where outside professionals were engaged to manage the business. The appointment of the outside professional could provide the confidence necessary to reassure creditors and suppliers and instill confidence in the business. Other types of approaches could be adopted which might leave the management authorized to make decisions relating to the day to day activities of the business, but subject to supervision by an administrator or the courts or to some standby supervision that could be available through the courts should it prove to be necessary.

71. It was observed that the note by the secretariat (A/CN.9/WG.V/WP.50) made no mention of the participation of creditors in management and monitoring of the business of the debtor, which could operate as a further check upon the activities of management. Where creditors had no confidence in the management that could be reason enough for their removal or for pursuing liquidation. It was also noted that the secretariat note did not clearly indicate the time at which the issue of control was important. A clear distinction could be made between control of the business in the period before the plan was prepared and approved and after the plan had been approved. While an administrator might be appointed in that early interim period, the issue of continuing management was one to be addressed in the plan, in terms of costs and what might serve the best interests of the business.

Preparation and content of the rehabilitation plan (paras. 117-122)

72. Different views were expressed as to which party should be given the opportunity to prepare the plan of rehabilitation. It was emphasized that preparation of the plan was a key element of the rehabilitation and one which addressed a number of sensitive issues such as future funding of the debtor. One view on preparation of the plan was that the debtor should be entrusted with that task, since the debtor would be in the best position to understand the business and had detailed information on the business. Another view was that that approach might not achieve the best result as the debtor might tend to undervalue the business and the debtor's view of what might be necessary to rehabilitate the business might not be sound. It might be more advantageous to the outcome of the rehabilitation to allow creditors to prepare the plan, or at least to be able to participate in its preparation, prepare a counter-proposal to any proposal of the debtor or amend any proposal made by the debtor (for which a procedure might need to be established). It was observed that one problem creditors might encounter in preparing a plan was access to sufficient information about the debtor, although it was suggested that the court or supervising body could order the debtor to provide the necessary information or that such information would have been made available in the period of investigation and examination which occurred at the commencement of the rehabilitation in some systems. A further view was that while an outside professional might be in a good position to listen to the interests of different parties, the outside professional should not be solely responsible for preparation of the plan, but could provide assistance as and where required.

73. One method of dealing with the need to involve those different parties in the process might be to give the debtor an exclusive period for preparation and, in the event that the debtor failed to do so, to allow the creditors and the administrator to prepare a plan. As a general principle, it

was suggested that what was required was an approach which was flexible, which did not give an exclusive right of preparation to any particular party (debtor, creditors or neutral third party such as the administrator), but which promoted consultation between the different interested parties (which might include parties such as trade unions and government agencies) and with experts as appropriate. Such a procedure was most likely to ensure the preparation of a plan that could be approved and implemented successfully.

The proceedings—approval of the plan (paras. 123-133)

74. An essential prerequisite to the process of approval of the plan was certainty as to who were creditors of the estate. Issues such as validity of claims; fraud; operation of avoidance powers; insider transactions; resolution of disputes; division into categories or classes of creditors (useful where there were creditors with distinctly different credits); calculation of percentage of value of claims (where that was a determinant of a majority vote); and general eligibility to vote needed to be addressed in order to ascertain who constituted the body of creditors and how it should be constituted for the purpose of voting on approval of the plan.

75. It was noted that no single procedure for approval of a plan could be specified since what was required varied from case to case; different majorities and different voting procedures might be required according to the content of the plan, the different types of liabilities involved and how minorities might be protected. A related issue was who could determine these issues—the courts, the administrator, an arbitrator or some other party.

76. On the question of majorities, it was noted that a system of simple majority by reference to number of creditors was likely to discriminate against large creditors, while those same large creditors might be unfairly advantaged if the only criterion was to be value of claims. Many systems adopted a combination of both number and value, but it was noted that that could also be problematic if a very small number of large creditors and a very large number of small creditors were to be involved in the same rehabilitation; one such example cited involved 29 banks representing 95 per cent of the debt and 2,000 creditors representing no more than 2 per cent of the debt (where the latter were able to defeat a plan agreed by the banks).

Powers of avoidance (paras. 134 and 135)

77. The Working Group exchanged experience on the operation of powers to avoid transactions (entered into prior to the insolvency proceedings) that unfairly favoured particular creditors. A general view was that avoidance powers were as important to rehabilitation as to liquidation, since in rehabilitation continuation of the business was the central concern and the availability of powers of avoidance needed to be maintained throughout the proceedings in order to facilitate a successful rehabilitation. By way of comparison, an example was cited in which the powers of avoidance could not be exercised in rehabilitation, but where the rehabilitation procedure was constructed in a manner which placed the burden of choosing between rehabilitation and liquidation (where avoidance powers *were* available) on creditors, and creditors in voidable transactions could be brought into the rehabilitation negotiations.

78. In some cases, powers of avoidance could be exercised by the administrator and in others the debtor in possession of the business could exercise those powers as a trustee. To avoid conflicts of interest where that debtor in possession might be reluctant to avoid transactions in which it had been closely involved, creditors or the court could intervene to compel avoidance of specific transactions.

79. Other cases were cited in which avoidance powers differed between liquidation and rehabilitation proceedings on issues such as that of timing; where liquidation followed a failure of rehabilitation, the powers of avoidance in the liquidation would allow the liquidator to avoid contracts entered into both before and after commencement of the failed rehabilitation.

Treatment of contracts (paras. 137 and 138)

80. A view was expressed about the propriety of termination of contracts (especially labour contracts), but it was noted that, in many cases of rehabilitation, it would be necessary to terminate burdensome contracts. At the same time, much of the value of the business to be rehabilitated might be in contracts and the ability to assume contracts, conditioned upon curing defaults, would be very valuable to the rehabilitation. It was noted that that might require a power to nullify contract clauses stipulating contract termination in case of insolvency proceedings. It was noted that many legal systems provided special treatment for certain types of contracts, including labour contracts, financial contracts and certain types of leases and licences. The special treatment of those types of contracts was generally grounded in a blend of public policy concerns, fairness and pragmatic accommodation of market concerns. As to the types of contracts which could be assumed or terminated, it was suggested that the insolvency law should adopt a flexible approach; experience with an insolvency law which required all contracts to be assumed had showed that approach to be detrimental to the estate.

81. The issue of damage was the subject of a number of comments and it was a widely held view that the exercise of powers of continuance and termination required a balancing between the benefits to be obtained for the estate and damage likely to be caused, particularly to counterparties. Labour contracts, for example, although generally regarded as exceptions to the exercise of those powers and usually more difficult to abrogate than other types of contracts, raised questions of balance between maintaining jobs and maintaining wages, especially where the maintenance of labour contracts would threaten the success of the rehabilitation.

82. The ability to assign contracts was noted as being of particular importance where the business was to be sold and transfer of certain contracts would be central to the sale. That power of transfer did not necessarily have to be

provided in the insolvency law since it might be available under general law provisions. Another issue noted as important was the time at which the option to continue or terminate arose; it was suggested that the option to exercise those powers should be maintained throughout the proceedings.

Post-commencement financing (paras. 139-141)

83. It was noted that post-commencement financing needed to address not only borrowed money credits, but also trade credits and extensions under existing contracts.

84. As to the question of what incentives could be provided to ensure that post-commencement financing could be obtained, it was observed that there were differences between the proposals set forth in paragraphs 140 and 141 of the note by the secretariat (A/CN.9/WG.V/WP.50). The IMF Report suggested that, while priority could be given over other administrative creditors, permitting the granting of a priority over secured creditors ran the risk of undermining the value of security. The ADB Report on the other hand suggested that a "super" priority could be given to ensure that funding for necessary on-going and urgent business needs of the debtor would be available.

85. A number of different views were expressed on that important point. As a preliminary issue it was noted that before the administrator could decide how post-commencement financing could be secured, whether by way of security over unencumbered or partially encumbered assets or by the giving of a priority, it was crucial that the existing assets of the estate be valued. Another issue of a preliminary nature was the need to distinguish between finance needed before the rehabilitation plan was approved and finance needed for implementation of the plan. It was noted that funding for the latter would generally be addressed in the rehabilitation plan and would therefore involve negotiation with existing creditors. Some of those creditors might agree to make the plan viable by providing the necessary funding through a number of different arrangements which may not require the giving of any priority.

86. Where finance needed to be obtained before the plan was approved, a number of restrictions were identified as being necessary. One suggestion was that that type of finance should be approved by the court, although it was noted that in some jurisdictions the court tended to rubberstamp the application of the administrator because it lacked the necessary expertise to make what was essentially a commercial decision. Another view was that, while the giving of super priority might be important in some cases, the applicant for the super priority should be required to show that the finance was not obtainable in some other way and that adequate protection for other creditors was provided. It was suggested that the powers of administrators with regard to such priorities should be limited strictly, with consideration given to involving banks and creditors in the decision. In one system, the administrator was made personally liable for assets of the estate during the administration period and therefore needed to be particularly careful on the issue of giving securities and priorities.

87. It was pointed out that, in practice, creditors were generally involved in negotiations with administrators on such issues and that often there was a single large creditor which supported the rehabilitation and was prepared to put forward credit which could later be accounted for in the rehabilitation plan. On the issue of super priorities generally, the view was expressed that such priorities conflicted with the protection of creditor interests; the policy choice to be made required an evaluation of broader social issues, such as balancing and protecting of rights in rem and employment. Another suggestion was that if the goal of early commencement could be achieved, so that the value of the assets was likely to exceed creditor claims, there would be room to provide security for new money. If, however, the general practice was to commence at a late stage, problems with new funding would always arise because of the lack of excess value; the general issue related to the culture of using rehabilitation processes in different countries.

Pre-packaged and pre-negotiated rehabilitation (paras. 142 and 143)

88. The Working Group exchanged views about the availability of pre-packaged and pre-negotiated forms of rehabilitation, the extent of their use where they were available and how successful they could be considered to be. It was observed that in a number of cases where such procedures were available, they worked extremely well and provided an alternative to formal rehabilitation that was typically less expensive, less complex, less intrusive on the debtor's business (and therefore less disruptive) and capable of providing a quicker result.

89. In some types of cases, however, such procedures were not always successful, such as where there were unliquidated claims or numerous small claims. Those procedures were useful where the major lenders had reached agreement, but a few creditors refused to agree and prevented the required unanimity being achieved. In such cases the combination of the out-of-court procedure with an insolvency procedure provided the means of dealing with lack of unanimity and facilitating resolution of the rehabilitation, without losing the benefit of agreements reached under the pre-packaged procedure. It was pointed out that an important feature of such proceedings was the willingness of the courts to recognize agreement which had occurred before commencement of the application for approval, although it was noted that in some cases the court might have difficulty fulfilling the approval function where it had not been involved in the pre-packaged proceedings or was not sufficiently experienced in commercial matters. The issue of remuneration of professionals in such proceedings was raised as an issue for consideration.

Conversion from rehabilitation to liquidation

90. The Working Group discussed the effect of a failure to approve a plan of rehabilitation and whether the proceedings could or would then be converted to liquidation. While the laws of a number of countries did make provision for automatic conversion to liquidation in those circumstances, it was pointed out that the question was generally determined by the nature of the insolvency regime and whether proceedings were unitary or separate.

91. In the case of an insolvency regime with separate proceedings, efficient coordination between the proceedings was desirable, in particular in relation to the rules of the different proceedings and how the rules of, for example, rehabilitation might impact upon a subsequent liquidation. Issues of conversion between liquidation and rehabilitation were generally managed by the courts, which in some cases permitted conversion in both directions, in others only from rehabilitation to liquidation. In addition, conversion was permitted not only where there was a failure to approve a plan, but also at a later stage if there was a failure in implementation of the plan (see also above, para. 38).

Additional topics possibly to be considered

92. Following discussion of the core features of rehabilitation proceedings, the Working Group considered other issues which might be included as core features of an insolvency regime. The issue of insolvency of affiliated companies was raised and, in particular, the desirability of allowing petitions to be filed and considered in one court, rather than in different courts in the locations of the different parts of the company, leading in some cases to cross-border issues. It was suggested that, in practice, although insolvency law tended to focus upon individual entities, entities were often arranged in groups and that coordinated insolvency proceedings or a consolidated insolvency proceeding would have a number of advantages. Very often one entity was highly dependent upon the value of another within the group and insolvency proceedings in a single court would not only facilitate easier identification of creditors, determination of claims and assessment of value, but allow the overall situation of inter-company obligations to be comprehensively considered. It was noted, however, that the insolvency of affiliated companies raised the important question of piercing the corporate veil; in some countries this was permissible in order to include affiliated companies in the insolvency proceedings, while in others it was not.

93. It was suggested that the topic of insolvency of affiliated companies might be appropriate for future consideration by the Working Group.

(e) Involvement of creditors (paras. 144-147)

94. The view was expressed that it was important, as a general principle, to support the involvement of creditors in both rehabilitation and liquidation proceedings. This was noted as being of particular use where the debtor might have greater powers, as in rehabilitation, so that creditors could monitor the activities of the debtor and provide any necessary checks. It was suggested, however, that the general principle supporting creditor involvement needed to be balanced against a number of factors. Those factors might include: the cost of ensuring creditor participation and how those costs should be met; ensuring that any powers which creditors might have to participate or intervene in the proceedings did not unnecessarily interrupt the progress of the rehabilitation; issues of governance and duties with respect to, for example, treatment of commercially confidential material, as well as procedural issues such as formation of creditors' committees and voting; and how questions of self-interest and mala fides could be addressed.

95. In support of creditor involvement it was pointed out that creditors could perform both an advisory role and an advocacy function. Their involvement in the process might include providing expert assistance in realizing the assets of the estate, providing a check against fees and expenses charged against the estate and in relation to actions brought by the liquidator against third parties, as well as a supervisory function. Where creditors' committees were required, the time at which they should be formed was important, as well as whether in some cases it might be important to consider remunerating creditor representatives. Where the rehabilitation involved affiliated entities and different groupings of interests, the manner in which creditors could best be represented was a difficult issue and might require the establishment of separate committees.

(f) Liquidators and administrators (paras. 148-153)

96. At the outset of the discussion, it was observed that the availability of properly trained professionals had a major impact upon the achievement of orderly and efficient insolvency proceedings. To develop and maintain the experience and knowledge of such professionals it was essential to develop appropriate training and continuing education programmes.

97. Different qualifications were required of liquidators and administrators in different jurisdictions, with a trend towards setting higher standards being clearly evident in a number of countries. Both public and private practitioners were used, depending upon the type of proceedings being pursued. In some cases, for example, the administration of estates with minimal or no assets was undertaken by the public sector, while in others it might be undertaken by the private sector, either on a rotation basis or a no-fee basis. In other cases, liquidators were only appointed from the public sector, while administrators could be private professionals. The qualifications of the professional appointed to a particular case might depend upon whether accounting, legal or business skills were relevant to the proceedings being pursued. In some countries, licensing schemes were employed to regulate those professionals, with sanctions for improper conduct including deregistration. In addition, insolvency laws might require the liquidator or administrator to post a bond to guard against him or her absconding with assets or impose personal liability for protection of the value of the estate. Appointment of liquidators and administrators was often controlled by the court, with or without the involvement of creditors.

98. The remuneration of insolvency professionals was an issue of some concern in a number of countries, with various solutions being explored. In some cases, remuneration might be on an hourly basis, in other cases fees might be fixed, while a third possibility was to allow contingency fees. It was suggested that the latter might provide an incentive for the administration of apparently assetless estates, where the size of the fee would be dependent upon what assets the trustee could recover.

(g) The court (paras. 154-156)

99. The Working Group exchanged views about the role of courts in a number of different insolvency systems. The issues discussed included the core functions of the court in the insolvency proceedings; the type of courts that might be needed; and the experience and knowledge of judges and other relevant insolvency professionals, including issues related to training and continuing education.

100. On the first question of the core functions of the court, it was clear that a number of different functions were required, depending upon how the insolvency regime was structured and the emphasis placed upon court supervision. A distinction was to be drawn between court involvement in the liquidation process and in the rehabilitation process. With respect to overall supervision of the rehabilitation process, for example, it was suggested that that could be entrusted to an administrative body, with creditors having a significant input to a consultative process by which decisions were made. Only where problems were encountered in the process would the court become involved and perform a supervisory function.

101. Where the proceedings were unitary proceedings, the court might perform a supervisory role at an early stage before the opening of proceedings, with the emphasis changing to the creditors after the proceedings had been formally commenced. In terms of liquidation proceedings, it was generally expected that the court would perform a supervisory function, but the level of intervention differed between systems. In some cases, a high level of direct intervention was expected, while in others the court provided support to the process, serving as an arbiter to interpret the law, to impose sanctions and to assist in the recovery of assets on application.

102. A number of different views were expressed with regard to the types of court that might be required to facilitate the conduct of efficient and effective proceedings. In some jurisdictions, insolvency courts were specialized courts which operated with a high degree of centralization, enabling the development of considerable expertise in insolvency matters and facilitating the speedy and efficient treatment of cases and predictability of the outcome. In other cases, insolvency matters were handled by general commercial courts, some of which might have special insolvency chambers. Concerns expressed with regard to the establishment of specialized courts related to the integration of those courts (and their judges) within the general court systems; the domestic importance of insolvency law in comparison to other areas of law; and the satisfaction of a range of priorities and demands (some of which might be political), not just those of insolvency, within domestic legal systems as a whole.

103. What was emphasized was not so much the type of court which handled insolvency matters (and the need for specialized courts), but rather the availability of experienced and knowledgeable judges and insolvency professionals and a clear definition of the extent to which those judges and other professionals were expected to be involved in making what were essentially business judgements. At a broader level, it was suggested that the proposal for the establishment of specialized courts was really an expression of the need for certainty, predictability and transparency in the outcome of insolvency proceedings. Those qualities were needed not just to facilitate domestic proceedings, but might be of particular importance where issues relating to foreign investment were involved. As such, there was a need for a healthy court system in general, not just healthy insolvency courts, and the establishment of specialized insolvency courts was unlikely to resolve relevant issues in isolation from the court system more generally. What was required was the integration of training and continuing education solutions into the court system as a whole.

104. On the question of training, it was noted that judges and other insolvency officials and practitioners required not just a knowledge and expertise of insolvency law, but of commercial and financial laws more generally. In some countries, particularly Federal jurisdictions, judges dealing with insolvency issues were typically required to address a range of matters that might be covered by the laws of separate jurisdictions (i.e. both State and Federal laws) and therefore might require a broad level of practice and expertise. Functions of insolvency judges also often raised questions of the separation of the powers of the executive and the judiciary, particularly in terms of what might be characterized as administrative or judicial functions for the purposes of the structure of an insolvency law. It was noted that fostering cooperation and the exchange of views between judges from different jurisdictions could perform a valuable role in developing knowledge and expertise. In particular, it was suggested that practice statements addressing the mechanism of cooperation might be developed through judges' colloquia, such as those which had been organized jointly by INSOL International and UNCITRAL.

(h) Informal insolvency procedures, including out-of-court restructuring (paras. 157-160)

105. At various stages of the discussion, references were made to the fact that frequently an insolvent debtor and its creditors engaged in out-of-court collective negotiations with a view to finding an agreed solution to the debtor's financial difficulties. It was noted that such negotiations (which might include, e.g. fresh financing and restructuring of the debtor's operations), in order to be successful, had to include all creditors or at least creditors representing the critical part of the debtor's total obligations.

106. It was noted that such voluntary out-of-court arrangements were often the lowest-cost way of resolving an insolvent company's financial difficulties. They provided an important opportunity to preserve the ongoing business enterprise, preserve employment and, by preserving the going-concern value of the business, frequently maximized the value available to all interested parties. Out-of-court restructurings also avoided many of the costs, delays and difficult distributional issues faced in the context of plenary, court supervised, insolvency proceedings.

107. It was further observed that fast growing companies in developing economies often had numerous lenders based in different countries. When those companies encountered

financial troubles, it was often difficult for them to organize a productive out-of-court resolution with their multinational creditors from diverse commercial cultures. Voluntary arrangements were also impeded by the ability of individual creditors to take enforcement action and by the need for unanimous creditor consent to alter the repayment terms of existing classes of debt. In the context of complex international transactions it was especially difficult to obtain agreement from all the relevant parties. For those reasons, it was stated, existing non-binding measures designed to facilitate voluntary arrangements had been implemented with only limited success.

108. It was suggested that, in light of those considerations, an internationally developed mechanism for binding creditors could assist greatly in facilitating voluntary out-of-court arrangements. The view was expressed that the Commission could be instrumental in developing a legal mechanism that could be used in connection with voluntary arrangements. It was proposed that discussion might be confined to major cross-border insolvency situations and to financial indebtedness (i.e. banking and other financial loans), thus leaving aside creditors such as suppliers of goods or services and employees. The purpose of such a mechanism to be elaborated might be to set out conditions under which a solution agreed upon by a majority might be imposed on the minority, to provide for a stay of actions and executions by the creditor group covered, and to ensure that the minority group was treated fairly.

109. However, it was observed that financial loans were sometimes extended through banks in the debtor's country and that, therefore, the proposed mechanism should cover major financial indebtedness insolvency situations even if the creditors were from the same country as the debtor.

110. Comments were made that the strongest incentive to engage in such out-of-court negotiations was the imminence, effectiveness and credibility of proceedings to enforce private claims and securities and of involuntary court supervised insolvency proceedings and the desire of both debtor and creditors to avoid the disruptive and stringent consequences of those proceedings. When such court proceedings were not credible or effective (e.g. because of court delays or because they did not ensure equitable treatment of creditors), the debtor might not be willing to engage in out-of-court negotiations. Even the prospect of fresh financing linked to an informally negotiated solution might not be sufficient incentive for the debtor inasmuch as ineffective court proceedings allowed the debtor to delay having to meet its obligations. Furthermore, experience had shown that leverage was needed over some creditors who might hold out for full satisfaction of their claims.

111. Reservations were expressed regarding the proposition of elaborating a mandatory legislative mechanism designed to promote out-of-court negotiations. It was said that the informal process of out-of-court negotiations might be disturbed by the formality of the proposed mechanism. It was also said that the proposal was likely to encounter opposition, in particular in the banking community, and that therefore any further work should be preceded by consultations with the banking community. Furthermore, any such legislative concept might have to be tailored to conditions in various regions and, therefore, universal solutions were difficult to obtain. It was suggested that, to the extent formality was desirable, an institution instigating and promoting out-of-court negotiations could be useful, but such institutional arrangements did not lend themselves to internationally harmonized solutions. Concerns were also expressed about whether the court was an appropriate body to give rulings on what were essentially matters of business judgement.

112. However, opinions were also expressed that, while realizing potential difficulties and pitfalls involved in a mandatory legislative framework for out-of-court negotiations, the proposal should not be abandoned because a well-thought out mechanism might offer significant benefits. It was added that if the role of the court in informal negotiations was limited to the approval of the fairness of the outcome, that might be widely acceptable and would not be overly intrusive.

113. Noting the divergence of opinions, the proposal was left to be further considered at a later time during the current session of the Working Group.

114. The considerations continued in the context of the discussion of "informal insolvency procedures", which the Working Group found worthy of including among the core features of an insolvency system to be worked on by the Commission.

115. Views were expressed that the envisaged out-of-court negotiation mechanism might include a non-judicial forum that would be empowered, by agreement of the parties, to evaluate whether the arrangement negotiated between the debtor and the majority of creditors was fair and, if it was found to be fair, to bind the minority of non-consenting creditors.

116. In response to questions, it was suggested that the debtor and creditors would join out-of-court negotiations out of their own interest or pursuant to their contractual obligations, and that any legislative mechanism to be prepared should not establish a statutory duty for the debtor or creditors to participate in the negotiations.

117. In response to a further question as to why the process was limited to financial creditors and did not include creditors who had supplied goods or services to the debtor, statements were made to the effect that experience showed that financial creditors often shared the same or similar interests and therefore more easily organized themselves for negotiations with the debtor, which was not the case with trade creditors. Furthermore, the focus and goal of the out-of-court negotiations was typically the reorganization of the capital structure of the debtor and the provision of fresh financing, which was more easily addressed by providers of finance than by trade creditors. Moreover, the terms of agreement reached with the debtor often allowed trade creditors to "ride out" the debtor's crisis and be paid in full or make a smaller sacrifice than the providers of finance.

118. Several cautionary opinions and reservations were expressed about the proposed work. They included the

following: there was a danger that large and influential creditors might use the mechanism to impose their views without taking due account of the interests of small or dissenting creditors; the proposed process lacked transparency, which was potentially troublesome in view of the fact that the result was to be binding on the dissenting creditors; the envisaged mechanism should only be allowed to operate to the extent the negotiations were not covered by the laws and regulations in the debtor's country or by international treaties; it was essential that the envisaged mechanism should ultimately be subject to court control; the mechanism, in particular if it involved a non-judicial forum such as arbitration, was likely to be costlier than the mechanism involving court supervision and that the negotiations might take place at a place distant from the debtor's place of business, which might, for that reason, impose a substantial burden on the debtor and some creditors. In response, it was stated that experience with out-of-court restructuring showed that such proceedings were less costly and more efficient than court supervised rehabilitation proceedings.

119. It was considered that it was necessary to elaborate substantive criteria and rules under which minority creditors could be bound by an arrangement negotiated by the majority of creditors and that proper balance had to be found between the need to maintain confidentiality of certain types of information divulged during negotiations and the need for transparency of the process.

120. Statements were made, and the Working Group agreed, that much of the expertise and experience regarding out-of-court negotiations and arrangements rested in organizations such as the International Monetary Fund, the World Bank, The Group of Thirty, INSOL International and the International Bar Association and that any work in the Commission should be carried out in close cooperation with those organizations and with the financial sector.

121. After discussion, it was found that there was sufficient support in the Working Group for proposing to the Commission that it include in its agenda out-of-court arrangements between financial creditors and the debtor that included also the possibility of binding dissenting creditors.

Additional topics possibly to be considered

122. Following the completion of its discussion on issues related to rehabilitation and informal out-of-court procedures, the Working Group considered issues which might be added to its possible future work on insolvency proceedings in general. Suggestions for additional topics included: transactions requiring special treatment such as multilateral netting (which might be relevant in areas such as funds transfers, securities clearance and settlement, currency swaps and derivatives transactions); special categories of institutions such as banks, insurance companies, and security broker and dealer arrangements; State-owned enterprises; issues of liquidity where, for example, there was a need for a mechanism to facilitate trading of claims to provide capital (exit capital) to assist in rehabilitation; issues of corporate governance, such as the power to undertake new investments and raise new capital which in some countries was permitted, but in others might be restricted or limited by personal liability of management; sectoral issues where the focus would be upon specific industries and the insolvency issues peculiar to those industries (e.g. transportation and some manufacturing industries); international processes, including the implications of electronic commerce and computer-based information systems (e.g. in relation to the provision of notice and the facilitation of negotiations between geographically distant parties); issues relating to the administration of assetless entities and the giving of priorities, in particular the extent to which creditors should attain priority if they provided funds for ongoing rehabilitation; the insolvency of multinationals and the impact of insolvency on related entities; and issues associated with "phoenix" companies, where the management of an insolvent entity reappeared managing a similar entity with similar problems.

123. Following discussion, it was suggested that issues relating to transactions requiring special treatment and special categories of institutions should not be included in the list of possible additional topics because they demanded resources and expertise which might not be available to the Working Group (see para. 36). It was noted that a number of the other suggested issues were already addressed in other topics which it had been broadly agreed should be included in core features of insolvency regimes: State-owned entities had already been discussed as requiring inclusion (see para. 37); international processes and particularly electronic commerce might not be separate topics and could be discussed under relevant substantive issues; and liquidity issues could be included within the scope of the discussion on claims. "Phoenix" companies also raised a number of issues which would fall within those already discussed for inclusion, particularly fraud (see paras. 30 and 60), corporate governance and group insolvencies (see paras. 92 and 93) . On the issue of State-owned enterprises, it was suggested that a further issue for consideration might be those enterprises which operated on funding provided by the State and the extent to which they could agree to writing down of their loans.

124. At various stages of the discussion, mention was also made of the role of security interests in insolvency proceedings (e.g. treatment and priorities of secured creditors, the need to provide effective security for post-commencement financing). It was stated in that connection on behalf of the Asian Development Bank that one of its Regional Technical Assistance projects covered modernization of security interests law. It was suggested that, in light of the growing importance of security interests for the development of trade, it might be useful for the Commission to consider the topic at a future session. It was noted with approval that the secretariat was preparing a note for the thirty-third session of the Commission that would discuss the work of various international organizations in the area of security interests and the issues that have been left outside harmonization efforts so as to allow the Commission to consider whether any further work by the Commission was warranted.

D. Form and feasibility of possible future work

125. In terms of the way in which the Commission could address possible future work, it was observed that there were a number of different possibilities, some of which were introduced briefly in paragraphs 161-168 of the note by the secretariat (A/CN.9/WG.V/WP.50).

126. The simplest form of instrument which the Commission could prepare might be something in the nature of a comparative study, which examined how different issues were addressed in different legal systems. Another possibility was a guide which would outline practices and policy choices, setting out the advantages and disadvantages of the different choices and their implications for different systems.

127. An instrument at a higher level of complexity might be a legislative guide; the legislative guide currently being prepared by the Commission on the topic of privately financed infrastructure projects was mentioned. That instrument offered a guide for legislators to what might need to be modernized or changed in legislation on particular topics, by reference to comparative studies of different laws and practices and explanation of the various issues. It also included legislative recommendations, many of which were similar to model provisions or could be used to draft legislation.

128. A further type of instrument might be model statutory provisions on some specified topics within the field of insolvency. Flexibility could be built into such an instrument by the inclusion of options, which might be reflected by a number of techniques, such as exemplified by the UNCITRAL Model Law on Procurement of Goods, Construction and Services or the footnotes included in a number of model law texts prepared by the Commission. Flexibility could also be provided by way of a guide to enactment or other explanatory material.

129. A further possibility would be to provide a blue-print or route map which could include treatment of a number of the socio-economic choices that might need to be made.

130. It was observed that each of these types of instrument might not, itself, completely satisfy the requirements of each and every topic that might need to be addressed and that what might be required would be a combination of different approaches, each addressing specific topics.

131. The Working Group exchanged views on possible future work on insolvency law. A widely expressed view was that the Commission should be involved in future work on insolvency law in view of its universal representation and the successful conclusion of its work on the Model Law on Cross-Border Insolvency. It was observed that the working methods of the Commission could contribute to the acceptability of a text by taking into account a broad range of views, by consulting with and involving different classes of possible addressees for the text being developed and by conducting the process of negotiation of the text in the six languages of the United Nations.

132. In addition to those reasons, it was noted that further work by the Commission would serve to keep the issue of insolvency reform on the international agenda. It was also noted that the development of a common foundation for insolvency law could facilitate the development of expertise and sharing of knowledge on an international level. It was observed that the problems being faced around the world were similar, that a number of countries were looking for guidance in the solution of those problems and that the discussion in the Working Group had indicated various available approaches which could be used to resolve those issues.

133. Views were expressed as to the vehicle which could most appropriately be the subject of possible work by the Commission. There was general agreement that a universal, one-size-fits-all model law would not be feasible or desirable. As to other potential types of instrument, one view was that it would be premature to decide in favour of model provisions or some other instrument that could serve all purposes, but that, as far as possible, a legislative approach should be followed. A concern was expressed that if something less than a concrete legal text was to be pursued, it might not be a task to which the time of a working group appropriately could be devoted. A note of caution was expressed against deciding upon a work product that might not ultimately prove to be achievable or useful.

134. As an alternative to a single approach, it was suggested that it might be necessary to consider a combination of approaches such as model provisions or legislative recommendations, perhaps with options, as well as some principles, with policy choices discussed in explanatory material. While there was an appreciation of a number of common problems, there were several possible solutions and different environments in which different solutions would be appropriate. It was pointed out that, while the Working Group had discussed a number of topics related to insolvency law in which there were clear differences of approach, nevertheless, in a number of instances, those approaches could be reduced to one or more fundamentals which would lend themselves to treatment in model provisions or legislative recommendations. Other issues were more complex and might involve social policy issues which did not lend themselves to treatment in the same manner. In such cases, it might be possible to reach common ground on principles that could be adopted.

135. A further concern was expressed as to the timing of possible work by the Commission. It was pointed out that work currently being undertaken in a number of international organizations was not scheduled to be completed before the second half of 2000. It would be essential for the Commission to have the opportunity to consider the outcome of that work, to take it into account and to build upon it in any future work it might itself undertake.

136. The Working Group considered a tentative proposal which indicated that:

(i) Discussions by the Working Group demonstrated its ability to enhance and augment the work of these international organizations and to broaden the perspective of

the work to include the views and requirements of its members and observers. For example, members of the Working Group suggested that the key objectives of an insolvency regime included: controlling fraud in the insolvency context; developing an effective infrastructure to administer and implement the insolvency regimes; encouraging early initiation of proceedings; not discouraging entrepreneurial activity; integrating the insolvency regime into a modern commercial law framework that balanced global economic considerations and the social and economic policy choices of each State; and encouraging an efficient out-of-court restructuring alternative to deal with debts to financial institutions for borrowed money, possibly limited to situations with cross-border implications. The Working Group recognized that a number of different insolvency systems operated throughout the world which each had the confidence of the credit community, but reflected the interests of all parties and the emphasis of each State on particular key objectives.

(ii) In considering the core features of an insolvency regime, the Working Group again demonstrated its ability to build on the valuable work of other international organizations by identifying issues of concern to many States and recording suggestions or alternatives for addressing such issues in an insolvency law. By offering insights into the existing or proposed laws of their countries, delegates illustrated various possibilities for legislative treatment of particular core elements and noted the benefits and detriments of the different approaches. The Working Group also suggested the need to consider, as additional core elements, whether the law should be limited to juristic persons or include natural persons engaged in business; the powers and duties of liquidators and administrators; the engagement and compensation of liquidators, administrators and advisers who would be paid by the estate; the relationship of insolvency laws to those dealing with debt collection and enforcement; the treatment of affiliated persons and entities; and the issue of flexible versus fixed time periods in rehabilitation proceedings.

(iii) Based upon the exploratory session of the Working Group, it was clear that the Commission could make a positive contribution to the development of strong insolvency, debtor-creditor regimes which would have the confidence of all participants in the insolvency process. Different insolvency systems could serve this goal and the Commission could elaborate the key objectives, core features and alternative structures and components of such systems. Importantly, the Commission could take the work of the several organizations whose work has informed the Working Group's deliberations, expose it to further consideration by the Working Group and produce a final product which reflected the views of the Commission's broad and balanced group of members and observers. Such a product would provide a sustainable improvement to existing insolvency systems and not be simply a response to short-term crises.

137. The Working Group generally welcomed the proposal and heard a number of observations. It was suggested that, in addition to the matters indicated as being core features of an insolvency regime, there should be added the issue of the linkages between the different processes, one example being where there was a failure of rehabilitation the proceedings might be converted to liquidation. A general concern was expressed that possible future work by the Working Group should not be constrained by too specifically describing possible elements of that work at this stage. Another concern was that any work to be undertaken on out-of-court restructuring, while encouraging the use of such procedures, should clearly recognize the close connection between those types of procedures and the formal insolvency regime into which those procedures would have to be fitted. The focus of the Working Group could thus be upon strengthening formal insolvency regimes and encouraging, or at least not discouraging, the use of alternative, less expensive out-of-court procedures.

138. A suggestion was made that the macro-economic factors that had made insolvency a very topical and important issue in recent years might need to be set forth in order to clarify the need for future deliberations of the Working Group. Relevant factors would include: the maximization of credit and business opportunities, both domestically and internationally (involving a consideration of insolvency as an integral part of credit and financial opportunities in most countries); enhancing the efficacy of mechanisms for recycling economic assets; minimizing the assumption of sovereign debt (noting that efficient debt workouts and recycling keeps private debt private); and that the operation of those factors might lead to a reduction in systemic risk. It was added that the Working Group should not overlook, in its further deliberations, the central importance of structural, social and political factors in developing effective and efficient insolvency regimes.

139. After deliberation, the Working Group adopted the following recommendation:

"The Working Group recommends that the Commission give it the mandate to prepare: a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including consideration of out-of-court restructuring; a legislative guide containing flexible approaches to the implementation of such objectives and features, including a discussion of the alternative approaches possible and the perceived benefits and detriments of such approaches. A legislative guide similar to that being prepared by the Commission for privately financed infrastructure projects would be useful and could contain model legislative provisions, where appropriate.

"Should the Commission decide to undertake such a project, the Working Group should be mindful in carrying out this task of the work underway or already completed by other organizations, including the International Monetary Fund, the World Bank, the Asian Development Bank, the International Bar Association and INSOL International. The Working Group should seek their collaboration in order to benefit from the expertise these organizations can provide and to build on their efforts and should commence its work after receipt of the reports currently being prepared by the World Bank and the Asian Development Bank."

B. Working paper submitted to the Working Group on Insolvency Law on the work of its twenty-second session: Possible future work on insolvency law: note by the secretariat (A/CN.9/WG.V/WP.50) [Original: English]

CONTENTS

INTRODUCTION

1. The Commission, at its thirty-second session (1999), had before it a proposal by Australia (A/CN.9/462/Add.1) on possible future work in the area of insolvency law.[1] The proposal referred to recent regional and global financial crises and the work undertaken in international forums in response to those crises. Reports from those forums stressed the need to strengthen the international financial system in three areas—transparency; accountability; and management of international financial crises by domestic legal systems. According to those reports, strong insolvency and debtor-creditor regimes were an important means for preventing or limiting financial crises and for facilitating rapid and orderly workouts from excessive indebtedness. The proposal before the Commission recommended that, in view of its universal membership, its previous successful work on cross-border insolvency and its established working relations with international organizations that have expertise and interest in the law of insolvency, the Commission was an appropriate forum to put insolvency law on its agenda. The proposal urged that the Commission consider entrusting a working group with the development of a model law on corporate insolvency to foster and encourage the adoption of effective national corporate insolvency regimes.

2. The Commission expressed its appreciation for the proposal. It noted that different work projects had been undertaken by other international organizations such as the International Monetary Fund, the World Bank and the International Bar Association on the development of standards and principles for insolvency regimes. It noted that the broad objective of those organizations, while differing in scope and working methods as a consequence of their respective mandates and membership, was to modernize insolvency practices and laws. The initiatives taken in those organizations were proof of the necessity of assisting States to re-assess their insolvency laws and practices. Those various initiatives, however, were also in need of strengthened coordination, where appropriate, so as to avoid inefficient duplication of work and achieve consistent results.[2]

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

4. To facilitate that further study, the Commission was invited by the secretariat to consider the possibility of devoting one session of a working group to ascertaining what, in the current landscape of efforts, would be an appropriate product (such as a model law, model provisions, a set of principles or other text) and to defining the scope of the issues to be included in that product. Diverging views were expressed in response. One view was that more background work should be undertaken by the secretariat and presented to the Commission at its thirty-third session for a decision as to whether substantive work of elaborating a uniform law or another text of a recommendatory nature should be undertaken. Another view was that the question could be referred to one session of a working group, for the purpose of exploring those various issues, with a report to be made to the Commission at its thirty-third session in 2000 on the feasibility of undertaking work in the field of insolvency. At that time, the Commission would have before it sufficient information to make a final decision on that issue. It was emphasized that preparatory work for the session of the working group would require coordination with other international organizations already undertaking work in the area of insolvency law, since the results of their work would constitute important elements in the deliberations towards recommending to the Commission what it might usefully contribute in that area. It was pointed out that the importance and urgency of work on insolvency law had been identified in a number of international organizations and there was wide agreement that more work was required in order to foster the development and adoption of effective national corporate insolvency regimes.

5. The prevailing view in the Commission was that an exploratory session of a working group should be convened to prepare a feasibility proposal for consideration by the Commission at its thirty-third session. Subsequently, after the Commission had discussed its future work in the area of arbitration, it was decided that the Working Group on Insolvency Law would hold that exploratory session at Vienna from 6 to 17 December 1999.

6. This note is intended to serve as a list of issues and approaches that might be covered by an instrument to be prepared by the Commission. It does not presume to be exhaustive, and it is anticipated that issues will be raised in the discussion that have not been addressed in the note.

7. The Working Group may wish to review this note topic by topic, with a view to considering firstly, whether future work on the topic of insolvency is desirable and feasible and, if so, which topics, if any, might be addressed in future work. In examining these topics, the Working Group might wish to consider the state of current discussions and whether the solutions presented in this note may offer an appropriate approach. Further, the Working Group might also wish to consider what form of work product (such as model law, model provisions, a set of principles or other text) might be appropriate for addressing relevant policy considerations and potential options for solution of

[1] *Possible future work in the area of insolvency law: Proposal by Australia,* A/CN.9/462.Add.1.

[2] *Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17* (A/54/17), paras. 381-385.

the problems outlined in this note. This approach might assist the Working Group in reaching a working assumption on the form that any text might take. Such a working assumption might serve as a guide to any later deliberations of the Working Group and allow the form to crystallize as the work develops.

I. GENERAL BACKGROUND REMARKS

8. In the preparation of this note and the selection of issues referred to in it, the secretariat has relied upon earlier efforts and reports. Chapter II of this note briefly introduces the current work of international organizations in the area of insolvency law. Chapter III outlines key principles or objectives identified as important to an effective insolvency regime, while chapter IV discusses in some detail the core features of an insolvency regime. These two parts are based upon the Key Principles and Features of Effective Insolvency Regimes set forth in the Report of the G22 Working Group on International Financial Crises[3] and reports by the International Monetary Fund ("the IMF")[4] and the Asian Development Bank ("the ADB").[5] Chapter IV also includes the recommendations and proposals from those reports. Chapter V of this note provides brief background information on the different types of text that might form the basis of future work. It addresses some of the considerations raised by these different work products, including the potential of each type of text to contribute to the goal of developing a harmonized framework for effective national corporate insolvency regimes.

9. Before proceeding with a consideration of issues, it may be useful to clarify how certain basic terms used in this note may be understood. Most legal systems contain rules on various types of proceedings that may be initiated when a debtor is unable to pay its debts, referred to by generic terms such as "insolvency proceedings". Two types of insolvency proceedings may be distinguished, for which uniform terminology is not always used.

10. In one type of proceedings (referred to here as "liquidation"), a public authority, typically a court acting through an officer appointed for the purpose (referred to here as the "liquidator") takes charge of the insolvent debtor's assets with a view to transforming non-monetary assets into a monetary form, distributing the proceeds proportionately to creditors, and liquidating the debtor as a commercial entity. In some States this is the only type of proceedings used. Other terms used for this type of proceedings include bankruptcy, winding-up, *faillite, quiebra, Konkursverfahren.*

11. In the other type of proceedings (referred to here as "rehabilitation"), the purpose is not to liquidate the insolvent debtor, but to allow it to overcome its financial difficulties and resume normal commercial operations. These proceedings also are usually conducted under the supervision of a public authority, such as a court acting through an officer appointed for the purpose (referred to as an "administrator"). They are typically aimed at reaching an agreement between the debtor and its creditors about relief that should allow the debtor to reorganize its operations to restore its financial viability. Insolvency regimes may make provision for both liquidation and rehabilitation, as well as transfer from one process to the other in certain circumstances. Other terms used for this type of insolvency proceedings include rescue, reorganization, arrangement, composition, *concordat préventif de faillite, suspensión de pagos, administración judicial de empresas, Vergleichsverfahren.*

II. CURRENT ACTIVITIES IN INTERNATIONAL ORGANIZATIONS

12. The international organizations whose work is mentioned in this part are not mainly concerned with the unification of legal rules. Their interest in insolvency laws and practices arises from their work in the international financial system and the growing recognition that effective insolvency regimes play a major role in strengthening a country's economic and financial system so as to prevent financial crises and, where the crisis has occurred, are an essential mechanism for responding to that financial situation. The value of strong national insolvency regimes has been emphasized by these organizations.

A. Asian Development Bank (ADB)

13. The ADB Regional Technical Assistance for Insolvency Law Reform (RETA) project is being carried out as a part of the Law and Development activities of the ADB and is designed to provide a regional forum for government officials and others concerned with insolvency law reform and administration to discuss common problems in insolvency law reform and administration and explore regional and international best practice. In the context of the RETA, the inter-relationship between corporate debt, debt recovery and corporate insolvency was studied in eleven Asian economies. The Preliminary Comparative Report of the study seeks to identify, observe upon and estimate similarities and differences in the eleven economies regarding those interrelationships, to develop key areas for discussion and critical evaluation and to suggest key components of a "best practices model" which would be suitable for the region to deal effectively with problems of corporate insolvency and debt recovery. The Report proposes that the basic components be determined by reference to well-established and accepted policies and principles which are evident in the corporate insolvency regimes and related practices of many more fully developed countries. While the Report notes (1.6, p. 8) that there is a considerable degree of difference in the application and practice of these policies and principles among the various countries, it nevertheless underlines that there is, in these regimes, a reasonably basic degree of commonality of approach. It

[3] *Report of the G22 Working Group on International Financial Crises,* October 1998 ("the G22 Report").

[4] International Monetary Fund, Legal Department Report, *Orderly and Effective Insolvency Procedures: Key Issues,* May 1999 ("the IMF Report").

[5] Asian Development Bank, *Regional Technical Assistance Project, TA No: 5795-REG, Insolvency Law Reform: Preliminary Comparative Report,* 1999 ("the ADB Report"); also *Special Report: Insolvency Law Reform in the Asian and Pacific Region,* Law and Development at the Asian Development Bank, 1999 ed., ("the ADB Special Report").

suggests that it is therefore possible to spell out a basic policy framework of a commercially acceptable insolvency regime which appears reasonably suited to application in a market economy.

14. The Report is based on an extensive survey of a number of aspects of the eleven economies, including forms and structures of business organizations (concentrating on large and medium-size enterprises); the banking system and the availability of forms of financing for such enterprises, including secured financing and enforcement; unsecured financing and enforcement; attitudes towards financial difficulty and insolvency; informal processes; insolvency law regimes; foreign and cross-border aspects of insolvency law; the inter-relationship between lenders and borrowers; and a general assessment of various processes arising from these issues (pp. 6 and 7). The surveys were directed at the form and substance of the issues and processes, as well as the intangible or socio-political influences that might impact on the form and substance.

B. International Bar Association (IBA)

15. Committee J of the International Bar Association deals with insolvency and creditors' rights. A recent project is the Model Bankruptcy Code which is intended to harmonize substantive bankruptcy law by providing draft provisions on key components of bankruptcy law for those jurisdictions considering reform of their insolvency regimes. A first draft, dealing with liquidation proceedings, was completed in September 1997. It addresses topics such as tests for insolvency, powers of the bankruptcy representative, invalid pre-bankruptcy transactions and priority of creditors' claims and contracts. A further draft of the Model Law is currently being prepared.

C. International Monetary Fund (IMF)

16. In May 1999, the Legal Department of the IMF completed an internal report entitled "Orderly and Effective Insolvency Procedures: Key Issues". The Report discusses the major policy choices that need to be addressed by countries when designing an insolvency regime. Based upon a comparative study of selected insolvency laws, the Report discusses issues that are of universal importance, and weighs the advantages and disadvantages of possible solutions. While it does express certain preferences with respect to some of the more important policy choices, it does not attempt to propose standards.

17. The Report makes it clear that the approaches adopted to these issues vary in a number of respects, being attributable not only to divergent legal traditions but also to different policy choices. Although some of these choices may be labelled as being "pro-creditor" or "pro-debtor" in approach, the Report (p. 2) warns that "the degree to which rules set forth in an insolvency law are perceived as fitting within one category or the other is ultimately less important than the extent to which the rules are effectively implemented by a strong institutional structure."

18. The Report notes that it does not address several issues—the application of insolvency laws to individuals; legal mechanisms that address the liquidity problems confronted by national or local governments; insolvency of financial institutions; the complex relationship between corporate governance and insolvency; the law on secured transactions; general features of an independent and competent judiciary and out-of-court rehabilitation.

D. Organisation for Economic Cooperation and Development (OECD)

19. Since 1992, the Privatization and Enterprise Reform Unit of the OECD has been involved in a process of developing rules and policies for transition and emerging market governments in the area of legal reform, focusing on privatization, insolvency and corporate law. The work on insolvency law has centred on the transition economies, examining the relationship between insolvency procedures and enterprise restructuring, providing comparative overviews of different legal and policy frameworks for insolvency, exploring policy implications of the use of insolvency or similar procedures in privatizing State-owned assets. In the context of its special programme for Asia and in cooperation with the World Bank and the ADB, the OECD has undertaken to develop a dialogue, involving member country experts and officials, policy makers and experts from emerging market economies, on the design and implementation of insolvency systems. A meeting will be held in November 1999 to discuss a number of reports, to review progress in insolvency reform in the Asian economies, to consider current efforts to develop a framework for international insolvency proceedings and to offer recommendations for future work.

E. Working Group on International Financial Crises (G22)

20. The Report of the Working Group, completed in October 1998, identifies a range of policies and institutional innovations that could help prevent international financial crises and facilitate the orderly resolution of crises that may occur in the future. In particular, it identifies for consideration policies that could help reduce the frequency and limit the scope of future crises, improve creditor coordination, and promote the orderly, cooperative and equitable resolution of international financial crises that occur. The Report endorsed eight key principles and features of insolvency regimes which were formulated in consultation with the International Federation of Insolvency Professionals (INSOL International).

21. No specific recommendations were made in the Report about means of procuring adoption of insolvency regimes consistent with the endorsed principles and features. Rather, the Working Group envisaged that the enhanced international surveillance process under consideration in a number of forums would review national insolvency regimes, and technical assistance from the International Monetary Fund and the World Bank, together with scrutiny from capital markets, should help encourage improvements. Nevertheless, the Working Group urged that consid-

eration be given in the relevant forums to the development of additional means and incentives for encouraging the adoption of effective regimes.

F. World Bank

22. As part of the wider effort to improve the future stability of the international financial system, the World Bank is leading an initiative to identify principles and guidelines for sound insolvency regimes and for the strengthening of related debtor-creditor rights. The initiative is to be undertaken in partnership with a number of international organizations (including the IMF, the ADB, UNCITRAL, the OECD, the International Finance Corporation, the African Development Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, the International Bar Association and INSOL), which will provide guidance to the Bank and to a task force of experts.

23. The task force will prepare draft Principles and Guidelines on the basis of a series of working papers and an Insolvency Symposium (Washington, 13 and 14 September 1999). The working papers will examine a number of issues including the legal framework for insolvency, the institutional framework, economics of insolvency, regulatory frameworks, business and financial sector concerns, rehabilitation and insolvency alternatives, systemic crisis situations, State-owned enterprise insolvencies, bank insolvencies and debtor-creditor regimes.

III. KEY OBJECTIVES

24. Although treated differently in the various reports mentioned in this note, there is broad agreement on the key objectives which are important to effective insolvency regimes.[6]

A. Maximize value of assets

25. Insolvency law should provide for the possibility of rehabilitation of the debtor as an alternative to liquidation, where creditors would not involuntarily receive less than in a liquidation and the value of the debtor to creditors may be maximized by allowing it to continue.

B. Strike a balance between liquidation and rehabilitation

26. An insolvency regime needs to balance the advantages of near-term debt collection through liquidation (often the preference of secured creditors) against maintaining the debtor as a viable business through rehabilitation (often the preference of unsecured creditors).

[6]This discussion is based on the principles outlined in the G22 Report, pp. 44 and 45.

C. Equitable treatment

27. An insolvency regime should treat similarly-situated creditors, including both foreign and domestic creditors, equitably. Equitable treatment recognizes that creditors do not need to be treated equally, but in a manner that reflects the different bargains that they have struck with the debtor. The insolvency regime should address problems of fraud and favouritism that may arise in cases of financial distress.

D. Provide for timely, efficient and impartial resolution of insolvencies

28. Insolvencies should be resolved quickly and efficiently, avoiding undue disruption to the business of the debtor. To facilitate this, it may be useful to establish time limits in the law for the completion of certain matters and for the proceedings as a whole, to allocate responsibility for the process to the entity administering the debtor's assets, and possibly establish specialized courts or administrative tribunals to supervise the process.

E. Prevent premature dismemberment of the debtor's assets by creditors

29. The proceedings should be conducted in an orderly manner, and creditors should be restrained from prematurely dismembering the debtors assets by the imposition of a stay. This will enable a proper examination of the debtor's situation and facilitate both maximization of the value of the estate and equitable treatment of creditors.

F. Provide for a procedure that is predictable and transparent and which contains incentives for gathering and dispensing information

30. Relevant risk allocation rules should be clearly specified in the law and consistently applied to ensure that there is confidence in the process and that all participants are able to adopt appropriate measures to manage risk. Transparency is closely related to the objective of predictability and requires that participants in the process be given sufficient information to enable them to exercise their rights under the insolvency law. In addition, where the law provides for the exercise of discretion, it should also provide adequate guidance as to how that should be exercised.

G. Establish a framework for cross-border insolvency

31. To promote coordination among jurisdictions, insolvency laws should provide rules on cross-border insolvencies with recognition of foreign proceedings.

IV. IDENTIFICATION OF CORE FEATURES

32. The ADB and IMF Reports address a number of common issues to be addressed by an insolvency regime. In

terms of the legal framework required to support the process, the Reports indicate that an insolvency regime should resolve a number of questions:

1. the types of debtors that will be subject to the law;

2. the relationship between liquidation proceedings and rehabilitation proceedings;

3. when insolvency proceedings can be commenced;

4. the extent to which the debtor should be displaced from management once proceedings have commenced;

5. the class of creditors whose actions are stayed or may not be commenced;

6. the extent to which liquidators and administrators should have authority to interfere with or nullify contracts entered into by the debtor prior to the commencement of proceedings;

7. limitations to be imposed upon the formulation of rehabilitation plans and requirements for their approval and implementation; and

8. in liquidations, ranking of creditors for the purposes of distribution.

33. In terms of the institutional framework, key issues include:

1. the extent to which the process is to be supervised by the courts or special administrative organs;

2. the discretion judges and designated officials should have in the exercise of their duties; and

3. the extent to which courts and designated officials should have the authority to make decisions on economic and business matters, even over the objections of creditors.

A. Application of the law—individuals and enterprises

34. An important threshold issue is determining which entities, as debtors, can be subjected to a general insolvency law. To the extent that any entity is excluded from the process, it will not enjoy the protections offered by the process, nor be subject to the discipline of the process. A general insolvency regime can apply to all forms of corporation, both private and State-owned, especially those State-owned entities which compete in the market place and are otherwise subject to the same commercial and economic processes as privately-owned corporations. In addition to general insolvency law, there may be a need for establishing special regimes for natural persons and highly regulated entities, such as financial and insurance institutions and utility companies.

35. The ADB Report (2.4, p. 14) tentatively proposes that all corporations, both private and State-owned (with the exception of banking corporations), should be subject to the same insolvency law regime.

36. The IMF Report (p. 17) concludes that, while the exclusion of an enterprise from any form of insolvency regime should be avoided, it is recognized that countries may wish to establish special regimes outside the scope of the general insolvency law for individuals or highly regulated entities, such as financial institutions. However, government ownership of an enterprise should not, in and of itself, provide a basis for excluding an enterprise from the coverage of the general insolvency law.

B. The relationship between liquidation and rehabilitation

37. Where a debtor is unable to discharge its liabilities as they fall due, there will usually be a number of competing claims on the assets which, in some cases, may best be satisfied by liquidation, even if creditors only receive a portion of the value of their claims. In other cases, liquidation will not be the best course of action and a restructuring of the debtor's debt structure and operations could take place to save the entity as a going concern and ensure that creditors are fully repaid or receive at least as much as they would have through liquidation. A key question in the design and evaluation of insolvency laws will be the way in which balance is achieved between a variety of social, political and economic interests and encouraging participation in the system.

38. The IMF Report suggests that the need for liquidation procedures can be viewed from different perspectives: first, as addressing inter-creditor problems and secondly, as a disciplinary force that is an essential element of a sustainable debtor-creditor relationship. With respect to the first issue, the Report (p. 10) points out that,

> "an orderly and effective liquidation procedure addresses the inter-creditor problem by setting in motion a collective proceeding that seeks to achieve equitable treatment among creditors and to maximize the assets to be distributed to creditors. [...] this is normally achieved by the imposition of a stay on the ability of creditors to enforce their rights against the debtor and the appointment of an independent liquidator whose primary duty is to maximize the value of the assets of the debtor prior to distribution to creditors."

39. Regarding the ongoing debtor-creditor relationship, the IMF Report points out that the orderly and predictable mechanism to enforce the rights of creditors, which is characteristic of liquidation procedures, can be seen as an important factor in determining the lending decisions of creditors. Viewed more broadly, liquidation procedures can be seen as "promoting the interests of all participants in the economy, since they serve to facilitate the provision of credit and the development of financial markets" (p. 11).

40. With regard to rehabilitation, the ADB Report (2.2*(b)*, p. 12) discusses the economic theory (a more contemporary theory than the theory used to justify the liquidation process) which maintains that not all enterprises that fail in a competitive market should necessarily be liquidated. A corporation with a reasonable prospect for survival should be given that opportunity, especially since it can be demonstrated that there is greater value in keeping such corporations functioning.

41. In contrast to liquidation, rehabilitation allows time for a debtor to recover from liquidity problems, and to

restructure its operations and relations with creditors and interested parties to determine how the value of the debtor's assets can best be maximized to satisfy all claims. The degree to which formal rehabilitation procedures are relied upon to achieve these goals differs, as does the focus of the procedure and the way in which the different interests are balanced. Some regimes focus, for example, upon saving the entity as a going concern and maintaining the existing ownership structure, while others focus upon the claimants.

42. The IMF Report (pp. 11 and 12) notes that there are a number of reasons why formal rehabilitation procedures can provide a mechanism for enterprise rehabilitation that serves the interests of all participants in the economy. First, since out-of-court rehabilitation requires unanimity of creditors, recourse to formal rehabilitation procedures may assist in achieving restructuring where they enable the debtor and a majority of creditors to impose a plan upon a dissenting minority of creditors, especially where there are creditors who "hold-out" during out-of-court negotiations. Secondly, the Report points to the fact that the modern economy has significantly reduced the degree to which an entity's value can be maximized through liquidation. In cases where technical know-how and goodwill are more important than physical assets, the preservation of human resources and business relations are essential elements of value which cannot be realized through liquidation. Thirdly, long-term economic benefit is more likely to be achieved through rehabilitation procedures, since they encourage debtors to restructure before their financial difficulties become severe. Lastly, there are social and political considerations which are served by the existence of rehabilitation procedures which protect, for example, the employees of a troubled entity.

43. Commentators point to the particular importance of rehabilitation in transition economies where large-scale liquidation of insolvent enterprises, especially large-scale State-owned enterprises, could produce structural and social problems of a magnitude that could negatively affect the social fabric of the country and jeopardize its political viability.[7]

44. Although often treated as separate processes, there is significant overlap and interaction between liquidation and rehabilitation procedures and it may often be difficult to tell, at the time of commencement, whether the debtor should be liquidated or reorganized. One way of dealing with this issue is for an insolvency regime to include both processes, with the balance between the two to be determined by policy considerations. In some cases, for example, the law may presume that a company should be reorganized and liquidation procedures may only be commenced where that rehabilitation has failed. A different approach is the "unitary" proceeding, which provides that all insolvencies are conducted initially under the same rules, with proceedings only being separated into liquidation or rehabilitation once a determination has been made as to whether rehabilitation is possible.

[7]See, for example, Dr. Manfred Balz, and Henry M. Schiffman, "Insolvency Law Reform for Economies in Transition — A Comparative Law Perspective" Part 1, ("Balz and Schiffmann Pt. 1"), *Butterworths Journal of International Banking and Financial Law*, Vol 11, No. 1 (January 1996), p. 19.

45. The ADB Report (2.5, p. 14) points out that there are cost and efficiency advantages if both processes can be accessed under a single procedure. It cites, as an example, the corporation which, having sought formal rehabilitation and failed, could be automatically liquidated without the necessity of having to commence a new procedure for liquidation. The Report proposes that an insolvency regime should provide the possibility of accessing both the liquidation and the rehabilitation processes under a single procedure. The IMF Report (p. 14) suggests that the unitary approach offers procedural simplicity which may be of advantage where the capacity of the institutional infrastructure is limited. Since this approach, however, reflects a recent trend not yet adopted in the insolvency laws of many countries, the Report follows the twin-procedure model that still prevails.

46. This note considers formal liquidation procedures and rehabilitation procedures separately, identifying and discussing the core provisions of each process.

C. Liquidation procedures

47. The ADB Special Report (p. 11) identifies the common pattern of the liquidation process as follows:

1. an application to a court or other competent body either by the entity or the creditors;
2. an order or judgement that the entity be liquidated;
3. appointment of an independent person to conduct and administer the liquidation;
4. closure of the business activities of the entity;
5. termination of the powers of directors and employment of employees;
6. sale of the entity's assets;
7. adjudication of claims of creditors;
8. distribution of available funds to creditors (under some form of priority); and
9. dissolution of the entity.

1. Conditions for commencement of liquidation

48. While insolvency laws refer to different criteria for commencement, most use the liquidity or cash flow standard and require a general cessation of payments on liabilities as they become due. As the IMF Report (p. 18) points out, reliance on this standard, as opposed to a test requiring greater financial distress such as insolvency, is designed to activate proceedings sufficiently early in the period of the debtor's financial distress to avoid a race by creditors to grab assets, causing dismemberment of the debtor to the collective disadvantage of creditors. Problems associated with this "preemptive" approach, such as the commencement of liquidation proceedings of a financially troubled, but nevertheless financially viable, enterprise, may be resolved by providing for the debtor to transform liquidation into rehabilitation.

49. In terms of access to the process, the ADB Report (2.6, p. 15) stresses the need for it to be convenient, inex-

pensive and quick. Restrictive access can deter both debtors and creditors, while delay can be harmful in terms of the dissipation of assets and the possibility of rehabilitation. Insolvency laws generally provide that liquidation proceedings can be initiated by either a creditor or a debtor. While the "general cessation of payments" requirement is often applied in both cases, in practice courts may be less demanding of evidence of insolvency in the case of a debtor application since this application will generally be as a last resort where the debtor is unable to pay its debts.[8] In the case of creditors, while they may be able to show that the debtor has failed to pay their own claim, providing evidence of a general cessation of payments may not be so easy. As the ADB Report (2.6, p. 15) notes, "although there should be a requirement of threshold proof, there is also a practical need for a creditor to be able to present proof, in relatively simple form, which establishes a presumption of insolvency on the part of the corporate debtor." Insolvency laws address this issue in a number of ways, including requiring the petition to be filed by more than one creditor or requiring the debtor to furnish information to the court to enable a determination of a general cessation of payments to be made. The ADB Report suggests that clear evidence of a failure of the corporate debtor to pay a matured debt is all that is required.

50. A matter related to debtor-initiated insolvency proceedings is the possible imposition of a duty on a debtor to commence proceedings at a certain stage of financial difficulty. Clearly there may be advantages in establishing an obligation to take early action. In the case of rehabilitation, the chances of successful rehabilitation are increased by early action and in the case of liquidation, creditors' interests would be protected by preventing further dissipation of the debtor's assets. However, as the IMF Report (p. 20) suggests, such provisions may discourage management from pursuing an out-of-court restructuring agreement on the basis that delay in filing formal proceedings may lead to personal liability. Choosing not to rely on penalties to force a debtor to commence proceedings may require the adoption of incentives to encourage debtors to do so.

51. On the issue of commencement, the ADB Report (2.6, p. 15) tentatively proposes that:

> "Access to the process provided for under an insolvency law regime should provide for a quick, convenient and inexpensive procedure for both a corporate debtor and creditors, but with sufficient safeguards to protect against abuse of the process. Evidence should be provided of insolvency or financial difficulty of a corporate debtor."

52. The IMF Report (p. 20) concludes that:

> "Where the law establishes separate liquidation and rehabilitation procedures, it should allow liquidation proceedings to be commenced on the basis of a petition filed by either a creditor or the debtor. When the petition is filed by a creditor, it is advisable that the principal commencement criterion be a demonstration that the debtor has ceased making payments generally. Various tests can be used as a means of determining whether, in fact, a cessation of payments is general. With respect to petitions filed by debtors, an important policy choice needs to be made as to whether the law should impose specific penalties on management for failure to commence proceedings upon a general cessation of payments. If it is decided that such penalties should not be imposed, it is advisable that, as an alternative, the law provide adequate incentives in the rehabilitation procedure to encourage debtors to utilize those procedures at a sufficiently early stage. In circumstances where the capacity of the judiciary is limited, it may be advisable to require that the court render a decision regarding the commencement of a proceeding within a specified period following the filing of a petition."

2. Effect of commencement

53. The issues to be considered under this heading relate to determining what constitutes the assets of the estate and to protecting those assets, both against the debtor and against creditors.

(a) Assets of the estate

54. The assets of the estate would generally include the property of the debtor as of the date the insolvency proceedings commence and assets acquired by the liquidator after that date.

55. Property in the first category would generally include both tangible and intangible assets owned by the debtor, whether or not in the possession of the debtor at the time of commencement. Assets not included in the estate would include those owned by a third party but in the possession of the debtor at the time of commencement and, in some cases, those assets being used by the debtor, but which are subject to a lease agreement where the lessor retains legal title. As the IMF Report (p. 22) points out, assets in the latter category may require special attention to ensure that the lease is not, in fact, a disguised lending arrangement. In such a case the lessor would be subject to the same restrictions as the secured lender.

56. Property in the second category would include assets acquired by the liquidator in continuing to operate the debtor's business prior to liquidation and those acquired by exercise of the avoidance powers.

(b) Protecting the estate

57. One of the principal goals of the insolvency process is to preserve the value of the estate. This will involve protecting it against the actions of both the debtor and the creditors, between the time a petition is filed and granted and after the proceedings have opened.

58. In respect of the first period, action may need to be taken to ensure that the debtor does not transfer assets out of the business or abscond from creditors and that the creditors do not take legal action which would have the effect of preempting the stay of actions against the debtor that will be imposed once the petition has been granted.

[8] Balz and Schiffmann, Pt. 1, p. 23.

The interim protective measures that can be taken against such actions, either by the court or at the request of a creditor, could include appointing a preliminary liquidator, prohibiting the disposal of assets and suspending the enforcement of security interests against the debtor. Since these protective measures are of an interim nature, the court may require evidence that the measure is necessary before an order for the posting of a bond will be given, especially in cases where the application for interim measures is made by a petitioning creditor.

59. Once the liquidation proceedings have opened, protection of the estate may require that control of the business be removed from the debtor and transferred to an appointed liquidator. There may be situations, such as where the business of the debtor is to be sold as a going concern, that justify permitting the debtor to retain some control over the business, even though the liquidator has complete control by virtue of his or her appointment and would be liable for any wrongful acts of the debtor during this period. Such a step would generally require consultation with creditors.

60. Protection of the estate against creditors during the period of the proceedings may require the imposition of a stay on the ability of creditors to enforce their legal rights. That stay may need to be imposed immediately to maximize the benefit to the estate and ensure that a fair and ordered administration can be achieved. The terms and conditions of the stay will need to balance the interests of the liquidator in having adequate time to maximize the value of the assets and, if appropriate, sell the business as a going concern, against the extent to which insolvency law should interfere with accepted commercial practices and processes, particularly as they relate to secured creditors. The IMF Report (p. 24) points out that there is little debate regarding the necessity of imposing a stay on the ability of unsecured creditors to attach assets as a means of enforcing their contractual claims and precluding all creditors from initiating legal proceedings to recover debts that accrued before the proceedings were initiated. The coverage of secured creditors, however, raises a number of issues (see paras. 65-69 below).

61. The ADB Report (2.7, p. 17) tentatively proposes that:

> "If the debtor corporation has applied for liquidation or if it is determined that the debtor corporation is only suited to liquidation, the powers of the existing management should be removed and an independent administrator should be appointed to assume those powers and the conduct of the liquidation. Secondly, the stay or suspension of actions and proceedings against the property of the debtor corporation should be confined to unsecured creditors only."

62. The IMF Report (p. 24) concludes that:

> "Upon commencement of the liquidation proceedings, all assets in which the debtor has an ownership interest as of the date of commencement should be transferred to an independent, court appointed liquidator. The debtor should be required to disclose all assets and questionable transactions.
>
> "During the proceedings, all assets over which the liquidator exercises control should be protected by a "stay" on the ability of unsecured creditors to enforce legal remedies against the assets of the estate. Although the scope of the stay may vary among countries, it should, at a minimum, preclude unsecured creditors from: (i) attaching, selling or taking possession of assets as a means of enforcing their claims or (ii) initiating legal proceedings to recover debts incurred before the liquidation proceedings were commenced.
>
> "[...] the stay should apply to secured creditors for a limited period [...].
>
> "Once a petition for commencement has been filed, it is advisable for the court to be given the authority to impose interim measures to protect the debtor's assets pending a determination of commencement by the court. The range of measures that should normally be available should include full or partial divestiture of the debtor's control over the assets, the appointment of an interim administrator and the imposition of a stay on the ability of creditors to attach assets."

3. The proceedings

General issues

63. A basic requirement of effective insolvency proceedings is that they be conducted in a timely, predictable and equitable manner, involving appropriate procedures for identification and collection of the assets of the estate, identification and verification of the liabilities of the estate, sale of the assets and distribution of the proceeds. These various stages of the liquidation process raise a number of issues.

(a) Verification of claims

64. Verification of the claims of creditors requires assessment of the legitimacy and amount of claims, as well as a determination of the category of the claim for distribution purposes. The burden of proving a claim generally lies with the creditor and to prevent delay, it may be appropriate to establish deadlines for the proof of claims. Where a regime allows challenges against a creditor's claims to be made, whether by the liquidator or other interested party, provision for dispute avoidance mechanisms, such as review by creditors of a final list of claims or some form of dispute resolution, could be included in the law.[9]

(b) Encumbered assets and secured creditors

65. The application of any measure, such as a stay, against the ability of creditors to enforce their security must weigh the basic purpose of insolvency proceedings against the purpose of creditor security and the availability of affordable credit, as well as the basic principle that contractual obligations should be honoured. If security is to achieve the aim of protecting creditors' interests in the event that the debtor fails to repay, then the creditor should

[9] IMF Report (note 4), p. 37.

not be delayed or prevented from exercising its security. At the same time, as the IMF Report (p. 25) points out, it has become increasingly recognized that permitting secured creditors to freely separate their collateral from other assets in the estate can frustrate the basic objective of insolvency proceedings, particularly rehabilitation, but also liquidation. Failure to limit the actions of secured creditors may negatively effect maximization of the value of the estate prior to distribution, especially where the sale of the business as a going concern is an option. In that case, individual enforcement of securities may be against the interests of secured creditors as a whole, as the claims may be worth more when the business is sold as a going concern than when it is liquidated.

66. The ADB Report (2.7*(c)*, p. 17) questions the extent to which the insolvency law should intrude into and interfere with accepted commercial practices and processes. The Report suggests that some form of stay will be required in order to ensure a fair and ordered administration, and supports the use of an "automatic" stay which comes into effect once an application has been made. Where there is a genuine aim of rehabilitating the debtor, the extent of the stay should be very wide and all embracing on the basis that rehabilitation will fail unless the essential assets and component parts of the debtor corporation and its businesses are maintained. However, since the same rationale is not relevant in cases of liquidation, the stay should only be applicable to unsecured creditors.

67. The IMF Report (p. 25) suggests that it is essential that any stay on the ability of a secured creditor to enforce its rights be accompanied by measures that serve to protect the interests of these creditors during the liquidation process. One approach would be to apply the stay automatically, but for a limited period, to enable the liquidator to commence the task of identifying and assessing the estate, with any extension being subject to a demonstration of need by the liquidator. Another measure to protect the interests of secured creditors relates to preserving or maintaining the economic value of the secured claim during the period of the stay.

68. The IMF Report (p. 27) outlines two ways of protecting the value of the secured claim. The first approach is to protect the value of the collateral itself, by providing compensation for depreciation which could be by way of substitute collateral or by making periodic cash payments corresponding to the amount of depreciation; by paying interest during the period of the stay to the extent that the creditor is oversecured (the value of the collateral exceeds the value of the secured claim); by providing the creditor with substitute equivalent collateral; or by paying the full amount of the secured claim where the liquidator wishes to sell encumbered assets. A second approach is to preserve the value of the secured portion of the claim, by valuing the asset on commencement of proceedings and, by reference to that valuation, determining the value of the secured portion of the creditor's claim. This value is fixed and, on distribution following liquidation, the secured creditor is given priority to the extent of that value. During the proceedings, the creditor will also receive the contractual rate of interest on the secured portion of the claim as compensation for the delay in realizing the asset.

69. The IMF Report (pp. 27 and 28) concludes that:

> "As a general principle, an insolvency law should strike a balance between, on the one hand, preventing secured creditors from undermining the objective of maximizing the value of the assets of the estate and, on the other hand, protecting the interest of such creditors so that the value of their security—and, as a consequence, the availability of credit—is not eroded. As a means of implementing this principle, an insolvency law should normally provide for the following:
>
> "*(a)* For a brief—and specified—period following the commencement of the proceedings (e.g. 30 or 60 days), the general stay on creditor enforcement should also apply to secured creditors, thereby precluding them from enforcing their contractual rights upon the collateral during the period of the proceedings, subject to the qualifications described below. The stay should normally only be extended beyond this period by the court upon a demonstration by the liquidator that such an extension provides a necessary means of maximizing the value of the assets of the estate for the benefit of creditors generally (e.g. because of the possibility of selling the enterprise or units of the enterprise as a going concern). It may be advisable for the law to impose a limit on the period of extension.
>
> "*(b)* Exceptions to this stay may be appropriate with respect to those assets that are generally not necessary for a sale of the business as a going concern (e.g. cash collateral).
>
> "*(c)* During the period of the stay, a mechanism should exist that ensures that the interests of the secured creditor are adequately protected. Where this protection is provided by preserving the value of the creditor's collateral, these measures should include, for example, compensation for the depreciation of the collateral and, if the collateral is to be used or sold by the liquidator, the provision of replacement collateral. Countries may, as an alternative, protect the interests of the secured creditor by fixing the value of the collateral at the commencement of the proceedings and giving the secured creditor a first priority claim based on that value, plus a priority claim for regular payments of contractual default interest.
>
> "Where the liquidator is unable to provide a secured creditor with the type of protection described above, the stay against the secured creditor should be lifted."

(c) Powers of avoidance

70. Since insolvency proceedings may commence at lengthy periods after a debtor first becomes aware that such an outcome cannot be avoided, there may be significant opportunities, as the IMF Report (p. 28) points out, to attempt to hide assets from creditors, incur artificial liabilities or make donations to relatives and friends. The result of such activities, in terms of the eventual insolvency proceedings, is to disadvantage general unsecured creditors, who were not party to such actions and do not have the

protection of security, and to undermine the objective of equitable treatment of all creditors. The purpose of avoidance powers, therefore, is to restore creditor equality and undo unfair transactions or unilateral legal acts which can harm the future estate and its creditors.[10]

71. The issue of avoidance powers is one that requires a balance to be struck between the value of strong powers to maximizing the value of the estate for the benefit of all creditors and the possible undermining of contractual predictability. The ADB Report (2.13, p. 22) suggests that "the debate over avoidance powers centres not so much on the policy behind the provisions, but on how effective in practice such provisions are and the somewhat arbitrary rules that are necessary to define, for example, time periods and the nature of the transactions themselves. There is some validity in the criticism that actual operation and enforcement of such provisions is not, in many cases, effective."

72. Notwithstanding possible criticisms, there appears to be general agreement that avoidance powers are important not only because they have an impact on maximizing the value of the estate for the benefit of creditors, but also because they contribute to establishing fair commercial conduct and are part of appropriate standards for corporate governance.[11]

73. The issues to be considered include whether avoidance should be possible in both liquidation and rehabilitation; what acts should be voidable and what criteria should be used, including whether or not certain transactions should be automatically void or voidable.

74. In some jurisdictions, avoidance rules apply only to liquidation, not to rehabilitation. Some commentators suggest that this prevents the full potential of rehabilitation being realized and distorts the choice between liquidation and rehabilitation.[12]

75. Avoidance rules may combine both objective and subjective elements. Objective criteria focus upon when the transaction took place in relation to the commencement of insolvency proceedings and the types of transactions at issue. Subjective criteria are based upon intent or knowledge which is specific to particular cases. While objective rules may be easy to apply, they may also lead to arbitrary decisions in cases where, for example, a legitimate transaction which falls within a specified period may be avoided, while a fraudulent transaction which occurred outside the specified period may be protected. Subjective criteria, on the other hand, may give rise to disputes and should be used only where really necessary. A balance needs to be reached between the two approaches.

76. The IMF Report (p. 29) points out that stricter rules should be applied to transactions and transfers made to insiders than to unrelated market parties, on the basis that insiders are more likely to be favoured and also tend to have the earliest knowledge of the debtor's financial difficulties. Categories of insiders would include those in a close corporate or family relationship, both past and present, with the debtor.

77. The IMF Report (pp. 29 and 30) identifies four categories of transactions that are most commonly covered by avoidance provisions: First, transactions and transfers made where there is evidence of the debtor's actual intent to defraud creditors by placing assets beyond their reach and where the counter-party knew of such an intent. These transactions would constitute actual fraud, since there is intent to defraud on the part of both parties. Many insolvency laws do not limit the period during which such transactions and transfers may be avoided. Secondly, transactions and transfers with a third party for inadequate consideration. An intent to defraud may be presumed whenever the transaction is unbalanced and does not appear to be made at "arms length". Some laws specify a maximum retroactive period calculated from the date of commencement, while others also require a finding of insolvency or imminent insolvency when the transaction or transfer occurred. Thirdly, transactions and transfers to creditors that are "voluntary". These concern the problem of preferential treatment, where a benefit may be given to an individual creditor which has no entitlement to that benefit. This may include, for example, early payment of a debt or granting a security to a previously unsecured creditor. Some laws specify a maximum retroactive period calculated from the date of commencement, while others also require a finding of insolvency or imminent insolvency at the time when the transaction or transfer occurred. Finally, ordinary transactions and transfers with creditors. This covers transactions which are normal in every respect except that they took place within a very limited period before the commencement of the insolvency, suggesting that there may be some preferential treatment. The period is generally limited to 30-90 days and some laws also require that the creditor knew or should have known of the debtor's insolvency. Some exceptions are made where the transactions are part of the normal course of business, such as payment for goods that are regularly delivered and paid for.

78. While certain transactions and transfers may be rendered automatically void by an insolvency law, in other cases it may be appropriate only at the discretion of the liquidator. In those cases, the discretion should be subject to the obligation to maximize the value of the estate, taking into account the cost and delays of recovering transfers.

79. The ADB Report (2.13, p. 22) tentatively proposes that an insolvency regime should contain adequate provisions relating to avoidance of transactions which result in damage to creditors or conflict with the principle of equal treatment of creditors of the same class.

80. The IMF Report (p. 31) concludes that:

> "The liquidation procedure should set forth a mechanism that enables the liquidator to recapture assets that the debtor transferred prior to commencement, where such transfers prejudice creditors generally. The avoidance provision should specify the type of transactions and

[10]See, for example, Dr. Manfred Balz and Henry M. Schiffman, "Insolvency Law Reform for Economies in Transition—A Comparative Law Perspective" Part 2 ("Balz and Schiffmann P. 2"), *Butterworths Journal of International Banking and Financial Law*, Vol 11, No. 2 (February 1996), p. 66.

[11]ADB Report (note 5), 2.13, p. 22.

[12]See Balz and Schiffmann, Pt. 2, p. 66.

transfers that should be covered and the maximum "suspect period" prior to commencement during which these transactions and transfers will be subject to avoidance. Stricter rules should normally apply to transactions and transfers with insiders. At a minimum, it is advisable for the following types of transactions and transfers to be included:

"*(a)* Transactions and transfers made where there is evidence of the debtor's actual intent to defraud creditors by placing assets beyond their reach and where the counter party knew of such an intent. No maximum period need be specified in the insolvency law.

"*(b)* Transactions and transfers for inadequate consideration, including gifts, that took place when the debtor was insolvent or about to become insolvent, with a maximum period specified.

"*(c)* 'Voluntary' transactions and transfers to creditors, where, for example, the debtor makes early payments on a debt or provides a security interest on an existing debt. A demonstration of actual or imminent insolvency may be necessary, with a maximum period specified.

"In addition, it may be desirable—but is not necessary—to provide the liquidator with the authority to nullify transactions and transfers to creditors that are not in any way irregular but which occur during a very brief period (no longer than 90 days unless the creditor is an insider) and where there is evidence that the creditor knew or should have known of the insolvency. However, there may need to be exceptions for transactions and transfers made in the ordinary course of business."

(d) Treatment of contracts

81. It is a common feature of many insolvency laws that the liquidator may interfere in contracts which are not yet fully performed by both parties, electing to either reject or continue (and possibly subsequently assign) these contracts. As in the case of avoidance rules, the underlying rationale is maximization of the value of the estate. That objective must be balanced against competing interests, social concerns raised by some types of contracts, such as labour contracts, and the effect on the predictability of commercial and financial relations of the liquidator's ability to interfere with the terms of unperformed contracts.

82. Various approaches can be adopted to the termination or continuation of different types of contracts. Some contracts may be terminated at the discretion of the liquidator, while others may be terminated automatically when the proceeding is opened, without the right of the liquidator to continue them.[13] Contracts may be continued at the discretion of the liquidator, with or without the agreement of the counter-party, subject to certain exceptions. Whether the liquidator elects to continue or terminate a contract, insolvency laws should require that, in order to provide certainty to the counter-party, notice be given within a specified period of time following initiation of the proceedings.

83. The rationale for rejecting contracts which are not yet fully performed is principally to "relieve the estate from intrinsically fair, but burdensome, contracts which the debtor may have concluded in the critical period preceding insolvency or which do not make sense any longer for the bankrupt enterprise and to enforce creditor equality against a party that only partially executed its obligations and gave the debtor credit for the latter's counter-obligation".[14] Where a contract is terminated, the counter-party is excused from performing the remainder of the contract and becomes an unsecured creditor for the amount of damages caused by the termination.

84. In considering the question of continuation, an initial question is whether the contract under consideration gives a right of termination for default where insolvency proceedings are initiated. Where such a clause is included, the contract would generally be terminated, unless the liquidator sought continuation and the counter-party agreed or the liquidator elected to continue the contract over the objection of the counter-party. There are cases where continuation will be more advantageous than termination. One example may be a lease of the business premises of the debtor, where the business can be sold as a going concern. Continuation may also be advantageous to the counter-party as payment under the contract may give priority for payment of services provided after commencement of the proceedings. In the event of continuation, the IMF Report (p. 32) points out that the interests of the counter-party can be protected by providing that costs of performance and any damage arising from a breach by the liquidator be treated as an administrative or priority expense. Since this will involve a risk for other creditors, a liquidator would generally only seek to continue contracts that would be beneficial to the estate.

85. The IMF Report (p. 34) identifies two general categories of exceptions to the power to continue contracts. The first is where the liquidator has the power to nullify termination provisions and specific exceptions can be made for certain types of contracts. These include short-term financial contracts like swaps and futures agreements. The second is where, irrespective of whether the law allows nullification of a termination provision, the contract cannot be continued because it provided for the performance by the debtor or personal services.

86. Contracts which have been continued may subsequently be assigned for value. In some insolvency laws agreement of the counter-party or of all parties is required, while in others non-assignment clauses are made null and void by insolvency proceedings and the liquidator is free to assign the contract for the benefit of the estate. As the IMF Report (p. 33) notes:

"While the ability of the liquidator to elect to continue and assign contracts in violation of the terms of the contract can have significant benefits to the estate, and therefore the beneficiaries of the proceeds of distribution following liquidation, this ability clearly undermines the contractual rights of the counter-party to the contract. Moreover, assignment raises issues of prejudice to the non-debtor party to the assigned agreement, especially

[13] Balz and Schiffman, Pt. 2, p. 67.

[14] Ibid.

where it has little or no say in the selection of the assignee."

87. As indicated above, some classes of contracts raise social concerns which may require special treatment under insolvency laws. One particular class is labour contracts, where the liquidator's ability to terminate may be limited by concerns that liquidation can be used as a means of expressly eliminating the protections afforded to employees by such contracts. This may be the case where the business is to be sold as a going concern and the elimination of onerous employment contracts could be beneficial to the sale price. Another class may be a lease agreement where the debtor is the lessee.

88. The IMF Report (p. 34) concludes that:

"Liquidation procedures should give the liquidator the authority to terminate or continue contracts that have not been fully performed by both parties. Designing the scope of this power requires the making of important policy choices: while broader termination or continuation powers serve to maximize the value of the assets of the estate, they also cause greater interference with contractual relations. Moreover, these powers may need to be limited with respect to certain types of contracts.

"*(a)* Termination—The liquidator should have the authority to terminate unperformed contracts. Upon termination, the counter party will become an unsecured creditor with a claim equal to the amount of damages caused by the termination. It is recognized that countries may choose to limit this power with respect to special contracts, such as labour contracts or lease agreements (where the debtor is the lessor), a limitation that will be relevant in liquidation proceedings where there is an intent to sell the enterprise (or a business unit of the enterprise) as a going concern.

"*(b)* Continuation and assignment—The liquidator should normally have the power to choose to continue performance of the contract (including assignment of performance) in circumstances where such continuation is not precluded by the contract's terms. If such decision is made, the counter-party should be afforded priority of payment (as an administrative expense) for any performance rendered after the commencement of the liquidation proceedings. If a country chooses to allow the liquidator to continue or assign a contract in contravention of its terms, it should require that the liquidator demonstrate that the contract can be adequately performed by the liquidator or the assignee. Exceptions to continuation powers will normally need to be made with respect to special contracts, such as financial and personal services contracts."

(e) Set-off

89. In the context of insolvency proceedings, recognizing a right of set-off would allow a creditor who is also a debtor to the estate to exercise that right after initiation of proceedings. The effect may be that, depending upon the amounts of the creditor's claim and the estate's claim against the creditor, the creditor may be paid in full. While this may appear to give an advantage to the creditor who is also a debtor to the estate, raising a potential issue about the equality of treatment among creditors, it can also be argued that it is unfair to refuse to pay a creditor while insisting on payment from that creditor. The IMF Report (p. 35) notes, in addition, that since many counter parties are banks, the right of set-off is particularly beneficial to the banking system and therefore, potentially, of general benefit to the economy. Banks which have lent to an entity against which insolvency proceedings have been commenced may also hold deposits of the debtor. A post-commencement right of set-off would allow the bank to offset its unpaid claims against those deposits, even where those claims are not yet due and payable.

90. The IMF Report (p. 35) also points to the interaction between a right of set-off and other provisions of insolvency law. It may, for example, be subject to avoidance provisions to the extent that the claim held by the debtor has been received by the creditor during the suspect period. It may also be limited by the liquidators' right to nullify termination clauses in a contract, unless the right to nullify is expressly limited to allow the creditor to terminate the contract and set-off mutual monetary claims.

91. The IMF Report (p. 36) concludes that:

"A pre-commencement right to set-off existing under general law should be protected during liquidation proceedings and generally should be exercisable by both the creditors and the estate. Moreover, the law should also permit post-commencement set-off if the mutual claims arise under the same transaction. In addition, countries may also wish to consider allowing for the exercise of set-off rights that arise under the general law after the insolvency proceedings commence, particularly with respect to mutual financial obligations."

(f) Disposition of assets

92. The manner of sale used by the liquidator should aim to maximize the value to the estate and follow a fair and transparent procedure. This may require that, for example, where the sale is conducted privately, it can be supervised, where appropriate, by the court, or creditors' approval is sought to avoid collusion.

93. The IMF Report (p. 38) concludes that:

"The procedure for liquidating assets should be timely and efficient and should provide for a sale that maximizes the value of the assets being liquidated. To that end, the law should normally allow for both public auctions and private sales, with the requirement that, in the latter case, the sale is either supervised by the court or approved by the creditors, or both. Adequate notice of any sale should be given to creditors."

(g) Priorities

94. The establishment of a system of priorities for distribution of the proceeds of the estate is important not only for facilitating the provision of credit, and particularly

secured credit, but also for ensuring the orderly and effective conduct of the proceedings. This includes making provision for payment of liquidators and ensuring that the objectives of the liquidation process can be achieved. Accordingly, insolvency laws may need to include rules which provide not only for distribution to creditors on the basis of the categorization of their claims (whether secured, unsecured, administrative or otherwise), but also deal with payment of liquidators and other administrative expenses.

95. Under such a system, secured creditors will have a first priority claim on the proceeds of the sale of the collateral to the extent of the value of the secured claim or to the general proceeds with respect to the value of the collateral, depending upon which method has been used to protect the secured creditor **(**see para. 68 above**)**. Where the secured claim is in excess of the value of the collateral or the value of the secured claim at commencement, the unsecured part of the claim will be treated for distribution purposes as an unsecured claim.

96. The first priority for distribution among unsecured creditors will generally be administrative expenses which cover court costs and fees of the liquidator, payments that were entered into or continued by the liquidator, and costs relating to collection, management, appraisal, and distribution of the assets of the estate. The rationale of this priority is in part to attract qualified professionals to liquidation work to ensure the orderly and effective conduct of insolvencies. Where secured creditors are involved in a liquidation, insolvency laws generally provide that secured claims should have priority over administrative claims. Some laws, however, provide that the expenses associated with preservation and sale of the collateral be deducted from the value of the collateral and the secured claims before secure creditors are paid, while another approach suggests that it may be reasonable to deduct those expenses from the administrative expenses of the estate. In some countries another expense that ranks with administrative expenses are claims for employee compensation that have accrued prior to commencement of proceedings.

97. Insolvency regimes vary considerably in the manner in which they treat distribution of remaining resources after the satisfaction of secured and administrative claims. Some laws identify different types of privileges which ensure the advancement in priority of certain classes of unsecured creditors. There may be a number of social and political reasons which justify the existence of privileges, such as the need to protect an economically less powerful class of claimants or the fact that certain classes of claimants, such as tort claimants, did not voluntarily extend credit on market terms, but are forced by the debtor or by law to "extend credit". The ADB Report (2.12, p. 21) points out that many insolvency regimes provide that debts such as tax debts and debts due to employees are to be paid in full, ahead of other creditors. Privileges, however, do have the potential to reduce the overall efficiency and effectiveness of the process and do establish an exception to the objective of creditor equality. In some cases privileges are said to be responsible for widespread disinterest in the proceedings on the part of general creditors and banks. For these reasons, the ADB Report notes that the modern approach is to endeavour to limit priority claims as much as possible.

98. Once the claims of privileged classes of creditors have been paid, the balance of the estate will be distributed to unsecured creditors on a pro-rata basis. This distribution will need to take account of subordinated claims. Some jurisdictions treat claims such as fines and penalties, gratuities, shareholder credits and post-petition interest on general unsecured claims as subordinate, while in other jurisdictions they are excluded or non-allowable claims.

99. The ADB Report (2.12, p. 21) tentatively proposes that:

> "An insolvency law regime should, as far as possible, preserve the principle of equal treatment for all creditors. Accordingly, the insolvency law should limit the number of priority claims to as few as possible."

100. The IMF Report (p. 41) concludes that:

> "The rules establishing the priority to be given to classes of creditors when distributing the proceeds of the sale of the estate's assets should pay due regard to contractual terms that provide for security or subordination. Thus, as a general rule, if the assets of the estate are encumbered, the proceeds of the sale of such assets should first be distributed to secured creditors to the extent of the value of their secured claim, plus any compensation arising from the stay that has not already been paid during the proceedings. Priority rules should also be designed to facilitate the effective functioning of the insolvency procedure. Accordingly, administrative expenses (including payment for the services of professionals, including the liquidator, and claims of post-petition creditors) should be given priority over unsecured claims. The inclusion of other statutory privileges, while they may be considered necessary for social or political reasons, should be limited to the extent possible since they generally undermine the effectiveness and efficiency of insolvency proceedings."

4. Discharge

101. Where claims remain outstanding once distribution has been completed, the question arises, with respect to certain enterprises, of whether the debtor should be discharged from those claims or whether they will continue to exist as outstanding claims. This is relevant to individuals, partnerships and unlimited liability enterprises where personal liability for unsatisfied claims may continue. The IMF Report (p. 42) identifies two approaches to this issue. The first emphasizes the value of the debtor-creditor relationship, with the continued responsibility of the debtor after liquidation serving to moderate a debtor's financial behaviour and encourage creditors to provide finance. The debtor will remain liable for unsatisfied claims, subject to the statute of limitations. The other approach, based on the benefits of a "fresh start", allows the honest, non-fraudulent debtor a complete discharge immediately following the liquidation.

102. The IMF Report (p. 42) recommends that:

> "The discharge of individual debtors following the liquidation of their enterprise may provide an appropriate means of giving them a fresh start. However, it should not be available to those that have engaged in fraudulent behaviour or who have failed to disclose material information during the proceedings."

5. *Foreign creditors*

103. The IMF Report emphasizes the need for insolvency regimes to treat foreign creditors in the same way as domestic creditors. In addition, both the ADB (2.15, p. 23) and IMF Reports (p. 68) emphasize the need for insolvency laws to adopt a common framework for cooperation in multi-jurisdictional insolvencies, pointing to the UNCITRAL Model Law on Cross-Border Insolvency.

D. Rehabilitation

1. *Essential features*

104. The ADB Report (2.2*(b)*, p. 12) points out that despite the fact that the rehabilitation process has not been as universal as that of liquidation, and may not therefore follow such a common pattern, there are a number of key or essential elements that can be determined:

(a) voluntary submission by an entity to the process, which may or may not involve judicial proceedings and judicial control or supervision;

(b) automatic and mandatory stay or suspension of actions and proceedings against the property of the entity affecting all creditors for a limited period of time;

(c) continuation of the business of the entity, either by existing management, an independent manager or a combination of both;

(d) formulation of a plan which proposes the manner in which creditors, equity holders and the entity itself will be treated;

(e) consideration of, and voting on, acceptance of the plan by creditors;

(f) possibly, the judicial sanction of an accepted plan; and

(g) implementation of the plan.

These issues are addressed in the following sections.

2. *Commencement requirements*

105. One of the objectives of a rehabilitation regime is to establish a process which will encourage debtors to take action to address their financial difficulties in a timely manner. Accordingly, the same commencement criterion as for liquidation (a general cessation of payments) should not apply, at least in the case of debtor-initiated proceedings. Some laws do not apply substantive criterion to commencement, while others adopt a criterion such as prospective illiquidity. As both the ADB and IMF Reports (2.5, p. 5; p. 45) note, however, there may be a need for safeguards to ensure that the rehabilitation process is not abused, either as a shelter or delaying tactic on the part of an entity which has no real prospect of rehabilitation or by allowing a debtor which is not in financial difficulty to propose a rehabilitation plan which would involve shedding onerous obligations, such as to employees.

106. Since a creditor is unlikely to be in a position to know of the prospective illiquidity of the debtor, a general cessation of payments would be a reasonable criterion to apply to creditor-initiated rehabilitation proceedings.

107. On the issue of commencement, the IMF Report (p. 46) concludes that:

> "The law should allow for rehabilitation proceedings to be initiated by the debtor or by a creditor. As a means of encouraging a debtor to commence rehabilitation proceedings early, thereby increasing the chances of a successful rehabilitation, the commencement criterion should not require a demonstration of a general cessation of payments. However, such a demonstration should normally be relied upon in the case of a petition filed by a creditor. The law should also provide for commencement of rehabilitation proceedings through a conversion from liquidation proceedings."

108. As noted above **(**para. 105**)**, there may be a need for safeguard provisions to prevent abuse of the rehabilitation process by the debtor. The ADB Report (2.5, p. 15) proposes that this issue could be addressed by requiring an early assessment of whether there is some real prospect of rehabilitation. Where the debtor fails that assessment, it could automatically be transferred to the liquidation process. The power to recommend or request such a transfer could be exercised by the administrator (other than management, the party most likely to have an understanding of the debtor's business) or the creditors' committee, or it could be given to the court. Reliance upon supervision by the court could be avoided by imposing time limits or giving greater leverage to creditors.

109. The ADB Report (2.5, p15; 2.12, p. 21) tentatively proposes that:

> "An insolvency regime should provide, as part of the rescue process, for an independent investigation and report of the affairs and financial position of the corporation. It should also provide for an independent assessment of any rescue proposal in respect of the corporation. If the corporation fails that or any subsequent assessment it should automatically be transferred to the liquidation process."

110. The IMF Report (p. 50) concludes that:

> "As a means of ensuring that rehabilitation proceedings are not abused by the debtor, it is critical that there be provisions that allow for the conversion of rehabilitation proceedings to liquidation proceedings. Such provisions should include a mechanism that allows the court to immediately convert the proceedings on its own motion, or upon a recommendation by the administrator or the creditors, when it is clear that rehabilitation is not feasible or when there is evidence that the debtor is acting in bad faith. To strengthen such a conversion mechanism, countries should also consider specifying in the law that rehabilitation proceedings may not, under any circumstances, exceed a specified period. Such time limits may be of particular importance in countries where the capacity of the judiciary is limited."

3. Consequences of commencement

111. While commencement of rehabilitation proceedings raises similar issues as a liquidation concerning the stay on the ability of creditors to enforce their legal remedies against the debtor and the control by the debtor of the estate, the approaches adopted in rehabilitation proceedings differ.

(a) The stay

112. The reason for limiting the ability of creditors to enforce their remedies in liquidation is to avoid a premature dismemberment of the debtor and allow the liquidator to maximize the value of the estate. This is even more important in the case of rehabilitation to ensure that there is a debtor which can be rehabilitated and to provide an incentive to encourage debtors to attempt rehabilitation as early as possible. As in liquidation proceedings, the question arises of whether the stay should apply to secured creditors and, if so, the duration of its application. As in the case of liquidation, where the stay does apply to secured creditors, measures may be needed to ensure the preservation and protection of the collateral, such as allowing the creditor to request relief from the stay or imposing time limits on the duration of rehabilitation proceedings.

(b) Control of the debtor's business

113. Where the debtor is normally removed from a position of control of the business under liquidation and the assets transferred to the liquidator, there is no agreed approach on the extent to which this should occur in rehabilitation proceedings. As the IMF Report (p. 47) points out, "if rehabilitation proceedings mirrored liquidation proceedings in terms of the degree of control that the debtor is given over the enterprise, such an approach would clearly undermine any incentive for the debtor to voluntarily make use of rehabilitation proceedings." The extent to which the debtor is allowed to retain control must be weighed in terms of the longer term benefits to the business (since the debtor is the party likely to have the best understanding of the business) and any negative effects, such as on the confidence of creditors. One approach is to allow the debtor to retain full control of the business, without the appointment of an independent administrator. As noted above in respect of commencement of rehabilitation proceedings (para. 105), however, there may need to be safeguards to ensure that the debtor is not simply using rehabilitation to delay the inevitable and allow the assets of the business to be dissipated, undermining the chances of rehabilitation and prejudicing the interests, and confidence, of creditors.

114. Sometimes the solution to this issue may depend upon whether the rehabilitation is voluntary or involuntary. One approach is to establish a sharing arrangement between the debtor and the administrator, where the latter supervises the activities of the debtor and approves significant transactions. In order to ensure that independent parties can ascertain the limits imposed upon the debtor and also be certain as to how the rehabilitation proceedings will operate, the division of powers between the debtor and administrator may need to be clearly defined and not left subject to broad discretion on the part of the administrator.

115. The ADB Report (2.7, p. 17) tentatively proposes that:

> "In the case of a genuine rescue attempt, [...] it is suggested that the existing management might continue but with overall supervisory and ultimate power in an independent administrator. Secondly, the stay or suspension of actions and proceedings against the property of the debtor corporation should apply to all creditors (secured or otherwise) for a reasonable length of time, but subject to applications by affected creditors for relief from the stay."

116. The IMF Report (pp. 48 and 49) concludes that:

> "It is important that the rehabilitation procedure provide for a stay on the ability of creditors to enforce legal remedies against the assets of the debtor once rehabilitation procedures are commenced. The scope of the stay should be at least as comprehensive as the minimum requirement outlined under Liquidation Procedures [...]. [...] the stay should also apply to secured creditors.
>
> "[...] a stay on the ability of secured creditors to exercise their rights against the collateral during the entire period of the proceedings is of critical importance. However, this does not reduce the need to provide such creditors with adequate protection (including relief from the stay when such protection cannot be given) and, in that context, this provides an additional reason for imposing time limits on the duration of the proceedings.
>
> "Total displacement of the debtor from the management of the enterprise will eliminate the incentive for debtors to avail themselves of rehabilitation procedures at an early period and may undermine the chances of successful rehabilitation. On the other hand, allowing the debtor to retain full control over the enterprise creates a number of risks, including the risk that the assets of the debtor will be dissipated to the detriment of creditors. For the above reasons, it is preferable for the law to provide for an arrangement whereby the debtor continues to operate the enterprise on a day-to-day basis, but under the close supervision of an independent, court-appointed administrator. However, the court should have the authority to displace debtor's management entirely in circumstances where there is evidence of gross mismanagement or misappropriation of assets."

4. The proceedings

(a) Preparation and content of the rehabilitation plan

117. In some jurisdictions the plan for rehabilitation of the debtor is prepared by the existing management of the debtor; in others it is prepared by an independent administrator, but in conjunction with existing management or ownership.

118. The rationale for allowing the debtor to prepare the plan is to foster utilization of rehabilitation procedures by debtors with financial difficulties and, as the IMF Report (p. 51) suggests, to take advantage of the debtor's knowledge of the business and of the steps that may be necessary to make the business viable, enhancing the chances of

achieving a successful rehabilitation. To ensure, however, that the plan prepared by the debtor will be accepted by creditors, it may be necessary to provide for some supervision or assessment of the preparation of the plan by the administrator. One approach to maximizing the debtor's potential involvement in preparation of the plan would be to provide an initial period during which the debtor has the exclusive right to propose a plan. Where the debtor fails to do so, either the creditors or the administrator (or both) could be given the right to do so. However, a situation which may involve a number of plans being proposed by different parties should be avoided as it may lead to unnecessary complexity and potential delays to the negotiation process. The manner in which this option is managed may depend upon whether or not the plan requires the approval of creditors and whether that approval can be overruled by the court.

119. Third parties, such as government agencies and labour unions, may also be given the option of providing their opinion on the plan.

120. The IMF Report (p. 50) concludes that:

> "As a means of encouraging debtors to utilize rehabilitation procedures, the law should normally provide the debtor with the opportunity to prepare a plan. This opportunity should not be given exclusively to the debtor. The administrator and/or the creditors should also be given the opportunity to prepare a plan, possibly after the expiration of an initial 'exclusivity' period. For purposes of enhancing the efficiency and effectiveness of the negotiation process, it is preferable that the law limit the ability of different parties to propose their respective plans at the same time."

121. In dealing with the content of the plan, the IMF Report (p. 52) points out that "virtually all countries have laws requiring, to a greater or lesser extent, that the rehabilitation plan should adequately and clearly disclose to all parties information regarding both the financial condition of the company and the transformation of legal rights being proposed by the proponent of the plan." Beyond the statement of general principle, the content of the plan is closely linked to the process and effect of approval, as well as to the relevance of other laws. To the extent, for example, that company law precludes certain dealings, such as debt-for-equity conversions, a rehabilitation plan including such conversions could not be approved unless the prohibition were removed. The application of other laws, such as those relating to foreign investment, may be more problematic. The IMF Report (p. 53) gives the example of limits on foreign direct investment which may affect the chances of rehabilitation where a number of creditors are non-residents. Equally, the financial difficulties of the debtor may provide an opportunity for foreign investors to obtain a controlling interest, which for policy reasons may not be desirable in certain circumstances. The same considerations apply to the case of labour laws and derogations that may need to apply in the case of rehabilitation.

122. The IMF Report (p. 53) concludes that:

> "With respect to the permissible contents of a plan, an insolvency law should normally only impose those constraints necessary to protect creditors that may be bound by the terms of a plan that impairs their rights without their consent."

(b) Approval of the plan

123. The ADB Report (2.11, p. 20) makes the point that, although an insolvency regime is a collective process, it cannot accord equality to different, competing interests, nor depend upon the need for unanimity within different interest groups for its application. Accordingly, the manner in which an insolvency regime deals with approval and effect of a rehabilitation plan will require a balance between the extent to which the process involves an impairment of the rights of creditors without their consent and the means by which the plan can be imposed, despite the dissent of a minority of creditors.

124. To the extent that the law provides protection for secured creditors and ensures that an approved plan does not interfere with the exercise of their rights, there may be no need for secured creditors to vote on the plan. That approach, however, may reduce the chances of success of the rehabilitation, especially where a secured asset may be central to the success of the plan. Unless, as the IMF Report (pp. 53 and 54) points out, the secured creditor is bound by the plan or the plan provides for full satisfaction of the secured creditor's claims, the exercise of that creditor's rights may render the plan impossible to perform.

125. One solution to this problem is to allow secured and priority creditors to vote on the plan as separate classes, where the plan might otherwise adversely affect the value of their claims or seriously impair their right to enforce the security. Where a majority of each of these classes votes in support of the plan, all secured and priority creditors can be bound by the plan. A measure which can be adopted to protect dissenting secured or priority creditors is to provide that they receive at least as much as they would have under liquidation. For some secured and priority creditors, including employees, support of the plan may mean weighing an immediate impairment of the value of their claims against the future of the entity and its long-term prospects.

126. A number of mechanisms can be used to deal with voting of general unsecured creditors. The first step is to identify the minimum threshold of support of general unsecured creditors required to bind that class of creditor and the means by which that threshold is to be attained. Whatever level of "majority" is required to establish support for the plan, the means of determining the majority may include reference to whether votes actually cast (as opposed to a potential number of those entitled to participate) represent the majority percentage of the value of the debt, the majority of the number of creditors or a combination of both. Although combining the requirements may make it more difficult to achieve the support required for approval, there may be circumstances where use of this system ensures a fair and equitable result as amongst creditors. One example cited by the IMF Report (p. 54) is where a single creditor holds a majority of the value of the debt; this rule would prevent it from imposing its support of the plan on all other creditors.

127. In some jurisdictions, general unsecured creditors are divided into classes. Such a division may be justified on the basis that unsecured creditors may have different economic interests and different aims in terms of what they want to receive from the rehabilitation plan. Some creditors might be more interested in the long-term prospects of the business and be prepared for a continuing relationship, while others are more concerned to receive immediate cash payments and have no further dealings with the business. An additional justification for creating classes relates to approval of the plan and the means by which the support of one class can be used to impose the plan on other classes.

128. Where different classes of creditors are required to indicate their approval of a plan by vote, rules may be required that allow the plan to be imposed on those minority creditors who oppose it ("cram-down" provision), but at the same time ensure that those creditors' interests are protected and priority interests respected. Laws which protect the rights of those creditors on whom the plan is imposed also apply a rule which provides that a dissenting class of creditors cannot be forced to accept less than the full value of their claims if creditors of a junior class receive any value ("absolute priority rule"). The IMF Report (p. 56) points out that the creation of classes of creditors and the application of such rules complicate the law and its application by the court and the administrator. Such complexity may be justified where institutional structures are sufficiently developed to deal with it, as it may enhance the chances of successful rehabilitation. In other cases, since the development of a complex system of classes and voting of creditors requires the exercise of discretion to make classification and voting mechanism choices, the burden placed on institutional structures may actually undermine the rehabilitation process.

129. Where the corporate form, capital structure or membership of the debtor entity may be affected by a plan, some laws provide for approval by shareholders. Where the plan is proposed by management, approval by shareholders may already have occurred, especially if required by the rules or laws governing the entity. The IMF Report (p. 56) suggests that this is particularly the case when the plan involves debt-for-equity conversions, either through the transfer of existing shares or the issuance of new shares.

130. The ADB Report (2.11, p. 21) draws attention to the need to ensure that, under any system of voting, voting powers are not manipulated and that the interests of genuine creditors are neither interfered with nor prejudiced by the voting powers of persons who are connected to the corporation (insiders).

131. Courts may have a number of powers with respect to approval and implementation of a plan. Many countries enable the courts to enforce the plan against creditors who may have dissented in the approval process; courts may also have the power to reject a plan, notwithstanding that it has been approved by the requisite majority of creditors on the basis that it does not adequately protect the interests of dissenting creditors or there is evidence of fraud in the approval process or that it is not feasible. The IMF Report (p. 56) notes that the plan may not be feasible because, for example, it does not bind secured creditors and does not provide for full satisfaction of the secured claims of those creditors. Exercise by those secured creditors of their rights would then make the plan impossible to perform.

132. The IMF Report (p. 57) concludes that:

"*(a)* It is important for the law to provide a means by which a plan can be imposed upon a minority of dissenting creditors while, at the same time, providing a mechanism that serves to protect the interests of such creditors to the extent that their interests are impaired. At a minimum, a dissenting creditor should not be bound by a plan if it does not provide it with at least as much as it would have received under liquidation.

"*(b)* As a means of enhancing the chances of rehabilitation, consideration can be given to allowing secured creditors and priority creditors to vote—but only as separate classes—and to enable the court to divide unsecured creditors with different economic interests into different classes. In addition, consideration can also be given to providing the court the authority to utilize the support of one class to make the plan binding on other classes. If this approach is adopted, rules such as the absolute priority rules should be applied so as to ensure that the dissenting classes of creditors are treated equitably in terms of priority ranking that applies in liquidation. The implementation of such an approach normally requires the exercise of discretion by the institutional infrastructure. Accordingly, in circumstances where the capacity of the institutional infrastructure is limited, the establishment of classes and cram-down authority may undermine confidence in the law and, therefore, its inclusion will require careful consideration.

"*(c)* If the requisite majority of creditors have approved the plan and it is also endorsed by the administrator, it is recommended that the law only give the court the authority to reject the plan in limited circumstances, such as where dissenting creditors have not been treated fairly or where there is evidence of fraud in the voting process."

133. The ADB Report (2.11, p. 21) tentatively proposes that:

"An insolvency law should make proper provision for the involvement of creditors as part of the liquidation or rescue process. In particular:

(a) the insolvency law should clearly define the voting rights of creditors and should describe minimum requirements for the approval of a plan of rescue;

(b) provision should be made for voting by classes of creditors, particularly secured creditors, if the rescue proposal is required to bind such classes;

(c) the law should also provide protection against manipulation of the voting system and, in particular, should ensure that a court or other tribunal is empowered to set aside the results of voting which are obtained by the exercise of votes of insiders or persons who are related to the corporation, its shareholders or directors; and

(d) the effect of a vote of the requisite majority of a class should be made binding on all creditors of that class."

(c) Powers of avoidance

134. The issues relating to costs and benefits of avoidance powers identified in respect of liquidation (paras. 70-80 above) apply equally to rehabilitation. One issue which does not arise in liquidation relates to avoidance of pre-commencement transactions where the debtor retains control of the entity during rehabilitation. In that situation, the debtor may be reluctant to seek to avoid a transaction for a number of reasons, particularly where there has been lending amongst related entities or the debtor may have a conflict of interest. In such a situation, creditors may need to have the power to seek avoidance of the transaction. The IMF Report argues that this is a reason for appointment of an administrator, especially where there is potential for this situation to arise.

135. The IMF Report (p. 59) concludes that:

> "The existence of avoidance provisions is a critical component of rehabilitation proceedings. The application of such proceedings may be more effective in circumstances where an independent administrator has been appointed."

136. The ADB Report proposal is set out at para. 79 above.

(d) Treatment of contracts

137. The issues concerning treatment of contracts which arise in the context of liquidation, especially where the business is to be sold as a going concern, also arise in a rehabilitation. The IMF Report (p. 59) points to specific difficulties in cases where the insolvency law does not provide for the nullification of contract termination clauses in the event of commencement of rehabilitation proceedings. This is especially important where the contract in question is crucial to the rehabilitation of the entity, such as a lease agreement.

138. The IMF Report (p. 59) concludes that:

> "The policy choices regarding the breadth of the power to interfere with contractual terms become particularly important in the context of rehabilitation procedures. Broad powers to continue or terminate contracts will significantly enhance the possibility of rehabilitation, but some countries may be concerned that the aggressive application of this power may undermine predictability. As under liquidation, if the administrator is given the authority to nullify termination provisions and/or the law does not provide for set-off of independent monetary claims, it is important that exceptions to these rules be made to allow for the netting of financial contracts."

(e) Post-commencement financing

139. While provision of on-going funding may arise in liquidation where a business has to be run for a short period of time prior to sale as a going concern, it is of critical importance where a genuine prospect of rehabilitation of the business exists. Insolvency regimes address this need by giving the administrator the power to obtain funding, either on a secured or unsecured basis, and subject in some cases to approval by creditors or the courts. Where the provision of security on unencumbered property or a second priority security interest on encumbered property are not sufficient to raise the necessary credit, some insolvency laws allow the administrator to give a "super priority" (priority over all creditors) or "super administrative priority" (priority over other administrative creditors).

140. The ADB Report (2.7, p. 17) tentatively proposes that:

> " [...] legislation should both sanction and provide a 'super priority' (ahead of all creditors) for funding of necessary on-going and urgent business needs of the debtor corporation."

141. The IMF Report (p. 60) concludes that:

> "Given the importance of new financing for an enterprise during rehabilitation, it is important that the law give the administrator adequate powers to obtain such financing. This should normally include the power to give a post-petition creditor administrative priority or a security interest on unencumbered assets. Where necessary, consideration may also be given to granting a creditor priority over other administrative creditors. In contrast, permitting the granting of priority over secured creditors is not recommended as it runs the risk of severely undermining the value of security."

(f) Pre-packaged and pre-negotiated rehabilitation

142. These techniques allow negotiation and voting for the plan to take place before commencement of the rehabilitation procedure, with court approval sought immediately after commencement. An alternative approach is for negotiation for the plan to occur before commencement, with formal voting taking place after commencement. The IMF Report (p. 61) outlines a number of advantages of these procedures. It combines the benefits and efficiencies of an informal process with the ability to impose a plan upon dissenting creditors, an important advantage of the form rehabilitation process. It provides certainty to the debtor with respect to control of the enterprise, as well as minimizing disruption of the business. Where the institutional infrastructure is limited, shortening the formal portion of the proceedings will be beneficial. One point to be noted, however, is that the debtor will not have protection from the actions of creditors during negotiations with those creditors.

143. The IMF Report (p. 61) concludes that:

> "As a means of enhancing the efficiency of the rehabilitation process, the law should allow for the approval by the court of rehabilitation plans that have been voted upon (or, at a minimum, negotiated) prior to the commencement of the rehabilitation proceedings."

E. Involvement of creditors

144. Both the ADB and IMF Reports (2.11, pp. 20 and 21; p. 62) underline the importance of the active participa-

tion of creditors as decision makers in a number of key areas of the insolvency process. Although their involvement in the liquidation process will generally be more limited than in a rehabilitation, creditors in liquidation proceedings may nevertheless have the power to dismiss the liquidator, approve the temporary continuation of the business by the liquidator and approve a private sale of the assets of the estate. Such involvement suggests that creditors need to be kept informed of the progress of the liquidation.

145. In rehabilitation proceedings, creditors would generally have the authority to dismiss the administrator, to propose and approve a rehabilitation plan and to request or recommend action from the court, such as conversion of proceedings from rehabilitation to liquidation. To facilitate creditors' participation in the process, a creditors' committee which represents the interests of different classes of creditors can be created to act on behalf of the creditors. While only performing an advisory function, the committee can facilitate the decision-making process by making recommendations on key matters for decision to both the court and to creditors. It can provide a forum in which differences between creditors can be resolved and serve as a vehicle for providing information to creditors.

146. The ADB Report (p. 21) tentatively proposes that an insolvency law should make proper provision for the involvement of creditors as part of the liquidation or rescue process.

147. The IMF Report (p. 63) concludes that:

> "The law should enable creditors to play an active role in the insolvency proceedings. To that end, it should allow for the formation of a creditors' committee, with the cost of such a committee being an administrative expense."

F. Liquidators and administrators

148. The IMF Report (pp. 63-65) identifies a number of issues in respect of the qualifications, appointment, dismissal, remuneration and liability of liquidators and administrators that need to be considered in insolvency laws. As court-appointed officials, both the liquidator and the administrator have an obligation to ensure that the law is applied effectively and impartially, and they will have to interact with the courts in a number of matters that are likely to arise in the course of the proceedings.

149. Given the potential complexity of both liquidation and rehabilitation proceedings, persons appointed to these positions will need to have adequate experience with commercial and financial matters and a knowledge of the law. To the extent that specialized advice is required to facilitate either process, that can be obtained by engaging specialists. Consideration needs to be given to how the official is appointed—such as from a list of eligible specialists—and whether the appointment should be made by the court.

150. As to dismissal, either official could be dismissed on the basis of a decision taken by the majority of unsecured creditors, or by the court, either of its own motion or at the request of any interested party. In the case of dismissal by creditors, consideration may need to be given to whether grounds for dismissal are required and, if they are not, whether any time limits should be imposed for dismissal without justification.

151. Whatever basis is chosen for remunerating liquidators and administrators, disputes with creditors can be avoided by adopting a transparent method which is explained to creditors at the beginning of the proceedings and which avoids the exercise of exclusive discretion by the courts.

152. The liability of the liquidator or administrator is another issue requiring consideration. Where they are appointed by the court, they will owe a duty of care to all interested parties and will be liable for breach of that duty. In determining what standard of care should apply to liquidators and administrators, regard should be had to the potential difficulty of the duties they undertake, the need to attract suitably qualified professionals and the means by which that liability can be reduced, for example, by obtaining the approval of creditors before taking any key decision.

153. The IMF Report (p. 65) contains the following conclusions on these issues:

> "*(a)* Given the central role that a liquidator and an administrator play in insolvency proceedings, it is important that they have an adequate knowledge of the law and sufficient experience in commercial and financial matters. To ensure that these officials have adequate integrity and expertise, countries may wish to consider establishing some form of self-regulatory licensing system.
>
> "*(b)* The court should have the authority to appoint the liquidator or administrator. The law should determine the conditions under which these officials can be dismissed by either the court or a majority of unsecured creditors.
>
> "*(c)* While a variety of methods can be used for determining the remuneration of a liquidator or administrator, it is important that the method chosen be transparent and that creditors be made aware of this method from the beginning of the proceedings.
>
> "*(d)* As court-appointed officials, liquidators and administrators have an obligation to ensure that the law is applied effectively and impartially. Accordingly, they owe a duty of care to all parties in interest and should be personally liable to all these parties for violation of this duty. As a general matter, the duty of care should only be considered violated in cases of negligence."

G. The court

154. Both the ADB and IMF Reports (2.8, p. 18; p. 66) address issues of administration of both liquidation and rehabilitation proceedings that concern the supervisory role of the court. The ADB Report (2.8, p. 18) notes that an insolvency law requires adequate administration and supervision to function effectively, both in respect of the initiation of the process and its orderly progression. It suggests

that "the experience in most jurisdictions is that a specialist court or other administrative body (or, certainly, experienced judges or officials) is often required to deal with the initial processing of insolvency cases and then be available to exercise a general supervisory capacity to ensure that the administration takes its course and that the system is not abused." The IMF Report (p. 66) also notes that an insolvency law will only be effective if the judiciary has sufficient capacity to implement it, underlining the importance of the relationship between the capacity of the judiciary and the design of an insolvency law.

155. The ADB Report (2.8, p. 18) tentatively proposes that:

> "The insolvency legislation should provide for swift and strict time limits for the initial processing of an insolvent corporation. The court or other tribunal system must be properly resourced to enable the process to be implemented.
>
> "The longer term administration of an insolvent corporation which is being liquidated may be conducted through a special government agency but with provision to enable more difficult and complex cases of liquidation to be administered by an outside independent specialist insolvency administrator. The government agency must be properly resourced to enable it to perform its functions efficiently.
>
> "Cases of rescue should be administered by an independent specialist administrator.
>
> "All cases of liquidation or rescue should be subject to supervision by the appropriate court or tribunal."

156. The IMF Report (p. 67) concludes that:

> "*(a)* As a means of ensuring that an insolvency law is applied with predictability, the law should provide adequate guidance with respect to how the court should exercise its discretion, particularly when the court's decision involves an assessment of economic and commercial issues.
>
> "*(b)* Since the insolvency proceedings give rise to a dynamic process, it is important that procedures be put in place to ensure that court hearings are held quickly and that decisions, including appeals, are rendered soon thereafter. During the period of appeal, the lower court's decisions should normally continue to be binding.
>
> "*(c)* Given the need to ensure efficiency and the proper exercise of discretion, countries may wish to consider the establishment of specialized courts, either in the form of bankruptcy courts or commercial courts. Whether or not a specialized court system is adopted, it is important that the judges have adequate training and experience in commercial and financial matters."

H. Informal insolvency procedures

157. Informal insolvency procedures have been developed in a number of countries over the last decade and provide alternatives to formal insolvency procedures that offer a greater degree of flexibility and early pro-active response from creditors than is normally possible under formal regimes. The ADB Report (pp. 25-27) describes the necessary conditions for informal procedures, as well as the main processes and practical problems. It also notes (p. 63) that, since the commercial culture of many of the countries studied for the Report are conditioned toward non-confrontational dispute resolution, there may be a relatively firm basis upon which to promote and build the elements necessary to structure an informal negotiated approach to the problems of insolvent or financially troubled debtors.

158. The ADB Report (p. 24) points to a number of well-defined initial premises that are required for informal processes to be effective. These include significant debts owed to a number of different creditors, usually banks or other financial institutions; a preference for negotiating an arrangement for financial difficulties of the debtor; availability of relatively sophisticated refinancing, security and other commercial techniques that can be used to rearrange or restructure the debts; the sanction of resort to insolvency law if the informal process breaks down; and the prospect of greater benefit for all through negotiation rather than formal processes.

159. The process of informal workout includes a number of steps: creation of a forum in which debtor and creditors can explore and negotiate an arrangement to deal with the debtor's financial difficulties; appointment of a "lead" bank creditor to organize and manage the process; establishment of a "steering" committee of creditors; an agreement to suspend adverse actions by both creditors and the debtor which may be compared to the stay of actions and proceedings in formal proceedings; and the provision of information on the debtor's situation, including its activities, current trading position and so on.

160. The ADB Report (pp. 25-27) raises a number of issues that may need to be resolved in developing an informal process. These include identifying which party may initiate the process and the tools that may be used to ensure the progress of that process; the extent to which independent experts and advisors should be involved in the process; the means of resolving differences between creditors, particularly with respect to competing priority rights; dealing with dissenting creditors and creditors that it may not be possible to actively engage in the process because of the sheer number of creditors; the provision of ongoing funding to the debtor entity and the establishment of priorities to secure that funding.

V. FORM OF POSSIBLE FUTURE WORK

161. Should the Working Group consider that further work by the Commission on all or any of the above issues is desirable and feasible, the Working Group might also like to consider what, in the current landscape of efforts, would be an appropriate product, such as a model law, model provisions, set of principles or other text. The following paragraphs address some of the considerations raised by these different work products, including the potential of each type of text to contribute to the goal of developing a harmonized framework for effective national corporate insolvency regimes.

A. Model law or model provisions

162. A model law is a legislative text that is recommended to States for adoption as part of their national law. In incorporating the text of the model law in its system, a State may tailor the text of the law to its needs and, if appropriate, modify or leave out some of its provisions. It is precisely this flexibility which, in a number of cases, may ensure greater acceptance of a model law than of a convention dealing with the same subject matter. However, notwithstanding the flexibility of a model law, States may be invited (e.g. by a resolution of the General Assembly) to make as few changes as possible in incorporating the model law into their legal systems, in order to increase the likelihood of achieving a satisfactory degree of unification and to provide certainty about the extent of unification.

163. A model law is an appropriate vehicle for modernization and unification of national laws when it is expected that States will wish or need to make adjustments to the uniform text to accommodate local requirements that vary from system to system, or where strict uniformity is not necessary. For example, in unifying the law of procedure, a uniform text may require, owing to different structures of the judicial system or on account of different procedural traditions, various modifications before the State can enact it as a national law. A model law would also be appropriate when the purpose of the uniform text is, on the one hand, to establish a standard of a modern law in an area where national systems are widely disparate, undeveloped or outdated and, on the other hand, to provide an incentive for a movement towards unification. An additional consideration that might favour a model law approach is the greater ease of negotiation over an instrument that contains obligations that cannot be altered.

164. Recent model law texts completed by UNCITRAL have included a guide to enactment, while previous ones have included an explanatory note. The purpose of the guide to enactment or explanatory note is to set out background and explanatory information relevant to the text which may assist Governments and legislators in using the text. The guide might include, for example, information that would assist States in considering what, if any, provision of the model law might have to be varied to take into account particular national circumstances, as well as information relating to discussions in the Working Group on policy options and considerations. In addition, matters not addressed in the text of the model law may be included in the guide by way of further explanation and guidance to States enacting the model law.

165. Within the category of model laws prepared by UNCITRAL, two texts, the Model Law on International Commercial Arbitration and the Model Law on Electronic Commerce, illustrate the flexibility of the form. The Model Law on International Commercial Arbitration, which could be described as a procedural instrument, provides a discrete set of inter-dependent articles. It is recommended that, in adopting the Model Law, very few amendments or changes are required. Deviations from the Model Law text have, as a rule, very rarely been made by countries adopting enacting legislation, suggesting that it has been widely accepted as a coherent model text.

166. The Model Law on Electronic Commerce, on the other hand, is a more conceptual text. Legislation adopting or proposing to "enact" the Model Law largely reflects the principles of the text, but may depart from it in terms not only of drafting, but also in the combination of provisions adopted or proposed for adoption. As such, and so far as it is appropriate to distinguish between a model law and model provisions, the Model Law on Electronic Commerce perhaps can be regarded as establishing a set of model principles, which are drafted in the form of legislative provisions to facilitate consideration by legislators and assist in the development of laws. Those principles do not necessarily form a discrete set in the same way as the Model Law on International Commercial Arbitration, but address a number of existing rules which may be scattered throughout various parts of different national laws in a typical enacting State. Accordingly, an enacting State may not necessarily incorporate the text as a whole into a free-standing law, but may adopt appropriate provisions into existing legislation. Nevertheless, the Model Law on Electronic Commerce does address the legal issues relevant to the establishment of a basic legal framework for electronic commerce, and while the model provisions do not purport to address all legal issues relevant to electronic commerce, they do provide an internationally negotiated set of principles which can guide legislators when considering and dealing with the issues covered.

B. Legislative principles or recommendations

167. It is not always possible to draft specific uniform provisions in a suitable form, such as a convention or a model law, for incorporation into national legal systems. One reason may be, for example, that national legal systems use widely disparate legislative techniques and approaches for solving a given issue, or that States are not yet ready to agree on a common approach or a common rule. A further reason may be that not all States perceive a sufficiently urgent need to find a uniform solution to a particular issue.

168. In such a case, it may be appropriate not to attempt to elaborate a text in the form of a model statute, but to limit the action to a set of principles or legislative recommendations. The purpose of these principles or legislative recommendations would be to assist Governments and legislative bodies in reviewing the adequacy of laws, regulations, decrees and similar legislative texts in a particular field. In order to advance the objective of harmonization, and offer a legislative model, the principles or recommendations would need to do more than state general objectives. These principles or recommendations would set out a number of issues often addressed in national laws and regulations and address the desirability of dealing with those issues in legislation. The text would provide a set of possible legislative solutions on certain issues, but not necessarily a single set of model solutions for the issues considered. It may be appropriate to include variants, depending upon applicable policy considerations. The text would assist the reader to evaluate different approaches available and to choose the one suitable in the national context.

C. Security Interests: current activities and possible future work: Report of the Secretary-General (A/CN.9/475) [Original: English]

CONTENTS

I. INTRODUCTION

1. At the UNCITRAL Congress, "Uniform Commercial Law in the 21st Century", held in New York in conjunction with the twenty-fifth session of the Commission in May 1992, a number of proposals were made for future work by the Commission.[1] Since 1992, the Commission has implemented several of those proposals, having prepared the UNCITRAL Notes on Organizing Arbitral Proceedings, the UNCITRAL Model Law on Cross-Border Insolvency, the UNCITRAL draft Convention on Assignment of Receivables and the UNCITRAL draft Guide on Privately Financed Infrastructure Projects. In addition, the Commission considered other proposals, such as the proposal to prepare a legal guide on privatization contracts, on which it decided not to undertake any work,[2] and the proposal to monitor implementation of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958), which the Commission is in the process of implementing.[3]

2. One of the proposals made at the UNCITRAL Congress, which the Commission has not had the chance to consider, was the suggestion for the Commission to resume its earlier work on security interests.[4] The matter has been reiterated in conferences all over the world over the last few years and has attracted the attention of legislators at the international, regional and national level, and of international and regional financial institutions, such as the European Bank for Reconstruction and Development, the International Bank for Reconstruction and Development and the Asian Development Bank (see paras. 15-18). With a view to informing the Commission about current activities in the field of security interests, facilitating coordination of efforts and assisting the Commission in its consideration of the matter, this special current activities report is intended to discuss briefly the earlier work of the Commission on security interests and developments in the area of security interests law in the last twenty-five years, identifying trends and problems, and to make suggestions as to possible areas for future work.

3. The very existence of widespread developments, both at the national and international level (see paras. 4-36), suggests greater acceptance than in the past of the central nature of this body of law to the functioning of modern credit economies. Moreover, these developments have moved the nations of the world, however slightly, toward a greater state of harmony. For both of these reasons, the present report, along with the report of the Working Group on Insolvency Law (see A/CN.9/469), may lead the Commission to consider with greater optimism than would have been possible in the past the possibility of further efforts in the area of secured credit.

[1] Uniform Commercial Law in the Twenty-first Century, Proceedings of the Congress of the United Nations Commission on International Trade Law, New York, 18-22 May, United Nations, New York, 1995, 268-274.

[2] *Official Records of the General Assembly, Forty-eighth Session, Supplement No. 17* (A/48/17), para. 310.

[3] *Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17* (A/54/17), paras. 331 and 332.

[4] Congress Proceedings, 159 and 271.

II. RECENT INITIATIVES

A. Governmental level

1. UNCITRAL

4. Secured transactions law has been on UNCITRAL's agenda since its inception.[5] With its pioneering work in the late 1980s, UNCITRAL set the stage for unification and harmonization efforts in the field of secured transactions law.[6] These studies led to the suggestion by the secretariat that the preparation of a model law would be both desirable and feasible.[7] At its thirteenth session in 1980, the Commission considered a note by the secretariat, which discussed issues to be considered and made suggestions as to possible solutions.[8]

5. However, at that session, the Commission concluded "that world-wide unification of the law of security interests in goods ... was in all likelihood unattainable". The Commission was led to that conclusion because it was concerned that the subject was too complex and the divergences among the different legal systems too many, as well as that it would require unification or harmonization of other areas of law, such as insolvency law. During the discussion at that session, it was noted that it was advisable for the Commission to await the outcome of the work on the retention of title by the Council of Europe and on factoring by the International Institute for the Unification of Private Law (Unidroit), prior to the Commission undertaking any further work of its own.[9]

6. After completion of Unidroit's work on factoring (see para. 7; the work of the Council of Europe on retention of title was never completed; see para. 10) and pursuant to suggestions made at the UNCITRAL Congress in 1992 (see para. 1), the Commission resumed its earlier work on secured transactions but only with regard to assignments of receivables in an international context.[10] The Commission is expected to review and finalize a draft Convention on Assignment of Receivables at its thirty-third session.[11] The draft Convention will cover traditional financing transactions, such as lending against sums owed for goods sold or leased, intellectual property licensed or services rendered. It will also cover sectors of secured financing which are of growing importance, such as securitization. The draft Convention would apply if the assignment or the receivable is international and the assignor (and, for the application of certain provisions, the debtor) is located in a Contracting State.[12]

2. International Institute for the Unification of Private Law

7. In 1988, Unidroit finalized two Conventions, one on International Financial Leasing and another on International Factoring ("the Ottawa Conventions"). Factoring and leasing are conceptually similar to secured lending. Factoring is a form of financing the operations of a business by converting its receivables to cash, a feature that this method of financing shares with lending against those receivables as security. In a lease, especially one conceived for financing purposes, the lessor's right to terminate the lease and regain possession of the leased goods also relates to secured lending. While the Ottawa Conventions are in force, they address primarily the contractual aspects rather than the proprietary security interests aspects of factoring and leasing.[13]

8. In1993, Unidroit announced its intention to prepare in due course a model law on secured transactions.[14] In 1994, three papers were published (i.e. preliminary considerations, an outline of a modern legal regime in the field of

[5]Report of the Commission on the work of its first session in 1968, *Official Records of the General Assembly, Twenty-third Session, Supplement No. 16* (A/7216), paras. 40-48 and Report of the Commission on the work of its second session in 1969, ibid., *Twenty-fourth Session, Supplement No. 18* (A/7618), paras. 139-145.

[6]The documents prepared in the context of UNCITRAL's work on security interests became common points of reference. Those documents are: A/CN.9/102, Security interests in goods, discussed in Report of the Commission on the work of its eighth session in 1975, ibid., *Thirtieth Session, Supplement No. 17* (A/10017), paras. 47-63; A/CN.9/130, A/CN.9/131 and annex, Study on security interests and legal principles governing security interests (study prepared by Prof. Ulrich Drobnig of Germany) and A/CN.9/132, Article 9 of the Uniform Commercial Code of the United States of America, discussed in Report of the Commission on the work of its tenth session in1977, ibid., *Thirty-second Session, Supplement No. 17* (A/32/17), para. 37 and Report of the Committee of the Whole II, paras. 9-16; A/CN.9/165, Security interests; feasibility of uniform rules to be used in the financing of trade, discussed in Report of the Commission on the work of its twelfth session in 1979, ibid., *Thirty-fourth Session, Supplement No. 17* (A/34/17), paras. 49-54; and A/CN.9/186, Security interests, issues to be considered in the preparation of uniform rules, discussed in Report of the Commission on the work of its thirteenth session in 1980, ibid., *Thirty-fifth Session, Supplement No. 17* (A/35/17), paras. 23-28.

[7]See A/CN.9/165, para. 61.

[8]Formal requirements for the creation of a security interest, actions required for the security interest to be effective as against third parties, priority issues, proceeds and remedies in the case of default (see A/CN.9/186).

[9]Ibid., paras. 26-28.

[10]From its twenty-sixth session in 1993 to its twenty-eighth session in 1995, the Commission considered three notes by the secretariat (A/CN.9/378/Add.3, discussed in Report of the Commission on the work of its twenty-sixth session in 1993, ibid., *Forty-eighth Session, Supplement No. 17* (A/48/17), paras. 297-301; A/CN.9/397, discussed in Report of the Commission on the work of its twenty-seventh session in 1994, ibid., *Forty-ninth Session, Supplement No. 17* (A/49/17), paras. 208-214; and A/CN.9/412, discussed in Report of the Commission on the work of its twenty-eighth session in 1995, ibid., *Official Records of the General Assembly, Fiftieth Session, Supplement No. 17* (A/50/17), paras. 374-381). At its twenty-eighth session in 1995, the Commission decided to entrust the Working Group on International Contract Practices with the task of preparing a uniform law on assignment in receivables financing (ibid., para. 379). The Working Group commenced its work at its twenty-fourth session in November 1995, by considering a report of the Secretary-General (A/CN.9/412). From its twenty-fifth session in 1995 to its thirty-first session in 1999, the Working Group considered revised draft articles prepared by the secretariat (A/CN.9/WG.II/WP.87, A/CN.9/WG.II/WP.89, A/CN.9/WG.II/WP.93, A/CN.9/WG.II/WP.96, A/CN.9/WG.II/WP.98, A/CN.9/WG.II/WP.102 and A/CN.9/WG.II/WP.104), and, from its twenty-ninth to thirty-first sessions, it adopted a draft Convention on Assignment of Receivables (see A/CN.9/455, para. 17 and A/CN.9/456, para. 18; and A/CN.9/466, para. 19).

[11]See A/CN.9/466, para. 215.

[12]An article-by-article commentary on the draft Convention is contained in A/CN.9/470.

[13]The Convention on International Financial Leasing has been ratified or acceded to by eight States and the Convention on International Factoring has been ratified or acceded to by six States (for the status of those texts, see *http://www.unidroit.org*).

[14]Unidroit 1993, C.D. 72 (18).

secured transactions and comments by the EBRD).[15] In 1995, a report was published about a meeting of international organizations involved in the preparation of legislation in the field of security interest law, which was held in Rome on 29 November 1994.[16] No further action has been reported on this matter since that time. The matter does not appear on the list of priority topics of the Unidroit Work Programme for the triennium 1999-2001, as approved by the General Assembly of Unidroit at its 52nd session, held in Rome on 27 November 1998.[17]

9. Unidroit is currently preparing, in cooperation with other organizations, a preliminary draft Convention on International Interests in Mobile Equipment ("the preliminary draft Convention") and Protocols on aircraft ("the preliminary draft Aircraft Protocol"), space equipment and railway rolling stock. Further protocols may be prepared in the future for other types of high-value mobile equipment. The draft Convention and Protocols are intended to create a new security interest in certain types of highly mobile, high-value equipment, such as aircraft, space equipment and railway rolling stock. The security interest is, for the most part, as comprehensive as the security interest under Article 9 of the United States Uniform Commercial Code ("UCC Article 9"), since it comprises, in addition to security interests proper, reservations of title and leases. Furthermore, while the security interest to be established is called "international", there is no need for it to be connected to more than one State and, if registered under the preliminary draft Convention, will, in the case of conflict, prevail over a purely national interest. At its session in 2000, the Unidroit Governing Council authorized the Unidroit secretariat to make the necessary arrangements for the holding of a diplomatic conference early in 2001 to finalize and adopt the preliminary draft Convention and Aircraft Protocol.

3. Council of Europe and European Union

10. Retention of title has been the object of two attempts at unification on the European level. In 1982, the Council of Europe's Committee on Legal Cooperation ("CDCJ"), on the basis of a thorough comparative study, prepared a draft Convention on retention of title.[18] However, the draft was not finalized by the Committee since several member countries apparently were planning reforms in this field. Work was adjourned indefinitely in 1986 (on retention of title, see also para. 19).[19] In 1997 and 1998, the Commission of the European Union published two versions of a draft Directive on Delays of Payment. Article 4 of this draft contained some rules on retention of title. However, a revised draft published in 1999 does not contain that provision.

11. In order to facilitate the efficient and cost effective operation of cross-border payment and securities settlement systems, the European Union, in 1998, issued a Directive on Settlement Finality in Payment and Securities Settlement Systems (Directive 98/26/EC of 19 May 1998). The Directive enhances certainty, at least with regard to the law governing the proprietary effect of a collateral arrangement which is subjected to the law of the member State where the relevant register, account or centralized deposit system is located (article 9 (2)). In addition, with a view to harmonizing the law on security interests in investment securities, the Commission of the European Union published in June 1998 a so-called "Framework for Action". The document was approved and was given high priority by the European Council summits at Cardiff and Vienna. In May 1999, the Commission published a document called "Financial Services Action Plan". The document was prepared by a Financial Services Policy Group constituted by the Commission and entrusted with the task of transforming into action the "Framework for Action". In the autumn of 1999, the Internal Market Directorate General, Financial Services of the Commission of the European Union established a Group on Collateral Law. The Group, which was composed of experts nominated by European organizations with wide experience, as well as sectoral and geographical expertise, held its second meeting in December 1999.[20]

12. The purpose of this project is to set the ground for the preparation of a Directive on a European Financial Security Interest ("EFSI") and a European Title Transfer ("ETT") relating to investment securities by the end of the year. The proposed regime would not change the nature of the asset given as security ("collateral") and the interest in securities under national law but would create a new security interest in investment securities. The regime would apply to collateral takers and collateral providers within the European Union and would extend across the whole range of commercial entities. For the creation of an EFSI or for an ETT, a written agreement signed by the parties (or by an agreement recorded and signed in electronic form) would be required. For the perfection of an EFSI or of an ETT, notification of the intermediary holding the interest for the collateral provider and entry into the books of the intermediary would be necessary. The collateral taker would be allowed to "use" (i.e. sell, lend, repurchase or pledge) the collateral, with the consent of the collateral provider, up until the time it is to be returned to the collateral provider. Upon default of the collateral provider, the collateral taker should be able to liquidate the collateral speedily, with the minimum formalities and without any assistance from or interference by courts or insolvency administrators. The legal regime envisaged would also deal with private international law issues. The law governing the collateral contract would be the law chosen by the parties. The law gov-

[15]Unidroit 1994, Study LXXIIA—Doc. 1, 2 and 3, October-November 1994.

[16]Unidroit 1995, Study LXXIIB—Doc. 1, March 1995.

[17]High priority was assigned to the preparation of a preliminary draft Convention on International Interests in Mobile Equipment and Protocols on certain types of such equipment, the second edition of the Unidroit Principles of International Commercial Contracts, a model law on franchising, transnational rules of civil procedure (in cooperation with the American Law Institute), a model law on leasing and uniform rules applicable to transport (see Unidroit Work Programme for the 1999-2001 triennium in *http://www.unidroit.org*).

[18]CDCJ, (82) 15.

[19]CDCJ (83) 36, paras. 20-25.

[20]The group took into account work carried out by other groups (e.g. the discussion paper "Modernizing Securities Ownership, Transfer and Pledging Laws", published by the International Bar Association in February 1996, the Report of the Giovannini Group "EU Repo Markets: Opportunities for change", published by the European Union in October 1999 and the Report "Collateral Arrangements in the European Financial Markets—The Need for National Law Reform", published in December 1999 by the International Swaps and Derivatives Association (ISDA). For information on ISDA and its work, see ISDA's website (*http://www.isda.org*).

erning effects as against third parties, in line with article 9 (2) of the Directive on Settlement Finality, should be the law of the location of the intermediary on whose books the collateral taker's interest is recorded.

4. Organization of American States

13. The Organization of American States (OAS) has recently begun work toward a model inter-American law governing secured transactions. At the request of the Secretariat of OAS, the National Law Center for Inter-American Free Trade (NLCIFT) has prepared several studies on secured transactions law and a draft model law which is inspired by UCC Article 9 and the Canadian Personal Property Security Acts ("PPSA's"). A meeting of governmental experts, held in Washington, D.C. from 14-18 February 2000, considered a number of papers, including a set of principles governing a system of secured transactions.[21] Such principles include: the creation of a unitary, uniform security interest; the automatic extension of the original security interest in property acquired after the creation of the security interest and to proceeds from the sale of collateral; the special treatment of the interest of a creditor providing the funds for the purchase of goods that may be subject to security interests of other creditors; the special treatment of the interest of a buyer of collateral in the course of business; swift repossession or adjudication of the issue of possession of the collateral and private disposition of the collateral; and notice-filing (voluntary registration of a limited number of data). At that meeting, it was decided that a drafting group should be established to prepare the final version of the draft model law by the end of 2000.[22]

5. Organisation pour l'Harmonisation en Afrique du Droit des Affairs

14. The Organisation pour l'Harmonisation en Afrique du Droit des Affairs (OHADA), an international organization of twelve Francophone and two non-Francophone sub-Saharan African States, has recently been created for the purpose of unifying the business law of its member States and creating a secure, business-friendly legal and economic environment in sub-Saharan Africa. In 1997, it adopted a Uniform Act on Security Rights which is based essentially on French law, but includes certain novel provisions. In particular, the French rules on non-possessory pledge have been integrated into the Act, although the various types of tangible collateral and some intangibles are still governed by separate rules. While the OHADA Uniform Act creates a single register, it does not contain rules governing the cross-border movement of tangible collateral among the member States.

[21]OEA/Ser.K/XXI, REG/CIDIP-VI/INF.3/00 and OEA/Ser.K/XXI, REG/CIDIP-VI/INF.2/00 of 14 February 2000.

[22]OEA/Ser.K/XXI, REG/CIDIP-VI/doc.6/00 of 18 February 2000, part III (conclusions and recommendations).

6. European Bank for Reconstruction and Development

15. A Model Law on Secured Transactions was elaborated by the European Bank for Reconstruction and Development (EBRD) and published in 1994. Its primary purpose was to assist the former socialist countries in Eastern Europe in the development of modern legislation on security interests in movables. One of the guiding principles for the preparation of the Model Law was compatibility with the civil law tradition of the Central and Eastern European States it was prepared for. The Model Law creates a single security right in respect of all types of asset available as collateral, including future assets and a changing pool of assets, such as inventory. The security right may be a registered right, a right of an unpaid seller or a possessory right. For the creation of all those rights, a written document is required. Priority is mainly determined in accordance with the time at which a right was created (i.e. in the case of a registered right, the time of registration; in the case of an unpaid seller's right, the time at which title is transferred; and, in the case of a possessory right, the later of the time mentioned in the written document and the delivery of possession). The Model Law has had a considerable impact on recent legislation, both in Eastern Europe and in Central Asia. However, it has been suggested that it is neither sufficiently compatible with civil law systems nor sufficiently innovative in introducing a uniform security right.

16. As a result of its experience with the process of adoption of the Model Law, the EBRD has been able to define a set of ten core principles for a secured transactions law. The overriding principles in this set of principles are that: security should reduce the risk of giving credit, leading to increased availability of credit on improved terms; the law should enable a quick, cheap and simple creation of a proprietary security right without depriving the person giving the security of the use of the collateral; and that if the secured debt is not paid, the holder of the security right should be able to have the collateral realized and have the proceeds applied towards satisfaction of the secured claim before other creditors.

7. World Bank and Asian Development Bank

17. The International Bank for Reconstruction and Development ("the World Bank"), in many of its recent lending operations, has shown an increasing interest in a reform of secured transactions law. Projects financed by the World Bank to reform secured transactions law are underway or are planned in a number of countries. Some of those projects are implemented in cooperation with other international financial institutions, such as the Inter-American Development Bank and the EBRD, or other institutions, such as the Center for the Economic Analysis of Law (CEAL).[23] The World Bank is also preparing a set of principles and guidelines addressing the legal, institutional and regulatory frameworks required for an effective insolvency

[23]CEAL has also been involved in national law reform projects financed by the Asian Development Bank. Publicly available materials on CEAL's work may be found at its website (*http://www.ceal.org*).

regime. In the context of this insolvency initiative, the World Bank recognized the importance of the availability of credit at affordable rates for a modern economy and of efficient legislation on security interests for the availability of such lower-cost credit. The tentative results of this initiative refer to the need for a legal regime which would, in principle, recognize security over all types of asset, movable and immovable, tangible and intangible, including inventory, receivables, investment securities and proceeds. Further principles of an efficient legal regime on secured transactions include: the flexibility in identifying the collateral; the possibility of creating a security interest in assets acquired after the conclusion of the security agreement and in all assets of a person; the availability of non-possessory security interests; the ease and cost-effectiveness of creation, perfection (effectiveness as against third parties) and enforcement of a security interest; and the transparency required with respect to security interests.

18. The Asian Development Bank (ADB) has carried out a survey of secured transactions and insolvency laws of several of its member States.[24] The results of the survey are contained in a report on Law and Policy Reform to be released by the ADB at its annual meeting in May 2000 (technical assistance projects TA-5795-REG: Insolvency Law Reforms and TA-5773: Secured Transactions Law Reforms). A part of the report, entitled "The need for an integrated approach to secured transactions and insolvency law reforms", highlights the close connection between, and the different objectives of, secured transactions and insolvency law, as well as the need to ensure that these laws are compatible with each other. It notes that, in the area of creation, registration and enforcement of security interests, most of the aims of a developed secured transactions regime would benefit, and be compatible with, an insolvency law regime. In respect of the initial effects of a formal insolvency proceeding upon security interests, the report notes that there is a high degree of compatibility between secured transactions and insolvency law with respect to the recognition of security interests, the lessening or removing of any effects of rights of unsecured creditors on security interests and the non-intrusion into the enforcement rights of secured creditors, at least in the case of liquidation. According to the report, there may be less compatibility concerning the treatment of enforcement rights of secured creditors in the case of reorganization, but that problem may be addressed if the limitations on enforcement rights are time limited, are subject to sensible conditions and may be removed by the court upon an application of the secured creditor. The report suggests that "an integrated approach should be adopted for the reform of insolvency and secured transactions laws".[25] It also suggests that "the issues considered in this report be taken into account in framing good practice guidelines for the development of both secured transactions legal regimes and insolvency law regimes".

[24]Drafts of several relevant papers were discussed in the context of a symposium hosted by the ADB in Manila from 25 to 28 October 1999. The secured transactions laws of five, and the insolvency laws of ten, Asian jurisdictions were surveyed. The survey has been conducted by the Office of the General Counsel of the ADB in collaboration with a number of experts and CEAL.

[25]The need to ensure that secured transaction and insolvency laws are compatible with each other is also recognized in a report of the Group on International Financial Crises of the Group of 22, published in October 1998.

B. Non-governmental level

1. International Chamber of Commerce

19. The International Chamber of Commerce (ICC) has prepared a guide providing basic information with regard to retention of title (ROT) in nineteen jurisdictions (ICC publication no. 467). The scope of the guide is limited to sales transactions relating to moveable goods between merchants. As a result, retention of title arrangements relating to real estate or to intellectual property rights, or consumer sales on deferred payment terms and hire-purchase contracts, are not covered. The guide discusses the validity and enforceability of ROT clauses, in particular in the case of insolvency of the buyer and describes different types of clauses. It also discusses issues of private international law, pointing out the absence of uniform rules governing ROT clauses and drawing a distinction between the contractual and the proprietary aspects of ROT clauses. The contractual aspects are normally subject to the proper law of the contract, while the proprietary aspects are subject to the law of the country in which the subject to the ROT clause is located (lex situs). The guide further discusses the problem arising from the application of the lex situs if the goods are moved into another country.

2. International Bar Association

20. The International Bar Association (IBA) established in 1999 a subcommittee on international financial law reform (subcommittee E8) to formulate proposals for simplifying and improving the laws and practice governing secured credit. The subcommittee took as a starting point the core principles used by the EBRD in the transition economies of Central and Eastern European States. The subcommittee is currently conducting a survey of ten jurisdictions to determine how far the laws in those jurisdictions match up to the core principles. The initial results of the study are to be discussed at a conference on international financial law, to be held in Lisbon from 24 to 26 May 2000.

3. American Law Institute

21. In 1998, the American Law Institute (ALI)[26] established an International Secured Transactions Project. The goal of the project is to promote and assist the development of effective and efficient legal regimes for secured transactions in the contexts of international law, United States domestic law and the domestic law of other countries.[27] That goal is to be achieved through participation in the legislative process in the United States and facilitation of

[26]The American Law Institute (ALI) has played a major role in the development of the law governing secured transactions in the United States. UCC Article 9 is a joint creation of the ALI and the National Conference of Commissioners on Uniform State Laws (NCCUSL). The ALI has also contributed to the unification and harmonization of the state law in the United States through the preparation and promulgation of Restatements of Law.

[27]Laws enacted as a result of assistance provided by CEELI or IRIS are discussed in part III. With a view to providing an overview of current projects, their work is described in general terms in this part of the present report.

the development of secured transactions regimes in other countries, as well as through the preparation of substantive drafts to aid those processes. Such drafts could include: an articulation of the economically beneficial goals of secured transactions law in a credit economy; the preparation of restatement-like principles of United States law of secured transactions; the articulation of criteria for an efficient, effective and appropriate legal regime governing secured transactions; analysis and articulation of the need for, and operational issues with respect to, registration systems; the preparation of a model secured transactions code for enactment as the domestic law of a country; and the preparation of a model international secured transactions law to govern international secured transactions in an integrated and comprehensive fashion. A meeting, to be held in London on 18 July 2000, is organized by the ALI to discuss the next steps to be taken in the context of this project.

4. Central and Eastern European Law Initiative and Institutional Reform and the Informal Sector

22. The American Bar Association, through its Central and Eastern European Law Initiative (CEELI), has been providing assistance to Central and Eastern European, as well as to Central Asian, States. The assistance includes educational efforts in particular areas of law and assistance in the drafting of laws. In many cases, CEELI assistance has been given in the area of secured transactions. CEELI's host countries include Albania, Azerbaijan, Armenia, Belarus, Bosnia-Herzegovina, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania,, Moldova, Poland, Romania, Russian Federation, Serbia, Slovakia, Tajikistan, The Former Yugoslav Republic of Macedonia, Turkmenistan, Ukraine and Uzbekistan. Specific projects include: a concept paper on secured transactions (designed to be used by legislators, the paper provides options, comparing UCC Article 9 with the Model Law prepared by the EBRD); ongoing assistance with the development of a secured transactions law (Latvia, Lithuania and Romania) and education on the concept of a comprehensive secured transactions law (Croatia, Romania, Russian Federation, Slovakia).

23. The University of Maryland, Department of Economics, is a sponsor of the Institutional Reform and the Informal Sector (IRIS). IRIS helps create and implement reforms that facilitate economic growth and strengthen democratic procedures in countries that are in transition from command to market-oriented economies. In this context, IRIS has been providing both substantive and technical input to States upgrading their secured transactions systems, particularly in the area of registration systems. Specific projects include: developing a legislative initiative on secured transactions and a computerized pledge registry (Albania); drafting law on movable collateral and planning for a computerized registry system (IRIS—The Former Yugoslav Republic of Macedonia); reviewing the draft law on secured transactions, training in the operation of the State pledge registry and technical assistance in software development (the Ukraine Collateral Law Extension and Regulatory Reform Initiative); drafting and implementing a law and system for the collateralization of movable property (IRIS-Lithuania); organizing the International Conference on Secured Commercial Lending in the Commonwealth of Independent States (Moscow, November 1994); and a comparative study on the status of collateral law with reference to movable property in fourteen countries (Albania, Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Russian Federation, Slovakia, Slovenia and the Former Yugoslav Republic of Macedonia).

III. DIFFERENT APPROACHES IN NATIONAL LAWS

A. Comprehensive systems creating a unified concept of security interest

24. The first model of a unified, general security interest has been UCC Article 9. UCC Article 9 has been adopted by all 50 states of the United States including, after some delay, the civil law jurisdiction of Louisiana. UCC Article 9 was thoroughly revised in 1999, especially by broadening its scope, modernizing the registration systems within the states, and accounting more fully for situations in which the debtors granting security interests are located outside the United States.

25. Personal Property Security Acts sharing many of the concepts and methods of UCC Article 9 have now been enacted by all the common law provinces of Canada and provide for registration of all non-possessory security interests in personal property (movables and intangibles). The first one was the Ontario Act, which came into force in 1976. In 1992, the civil law province of Québec adopted a new civil code, which came into force in 1994 and which provides for a new regime on security in personal property. Although based on civil law concepts, this regime is functionally similar to UCC Article 9 and includes uniform registration requirements for all security devices that would be "security interests" under a UCC Article 9 type of law. New Zealand has also enacted a broad statute on Personal Property Security Interests (1999), and efforts are underway in Australia as well. In Europe, Norway (1980) and Romania (1999) have enacted comprehensive statutes covering, like UCC Article 9, a broad range of assets and security interests and providing for registration of most non-possessory security interests.

B. Laws governing possessory and non-possessory pledges

26. Many countries that have enacted new civil codes or comprehensive laws on property deal with two types of pledges, the traditional possessory pledge and the modern non-possessory pledge. This approach was followed in the civil codes of Georgia (1997), the Netherlands (Book 3 of 1992), Québec (1992) (the unified interest is called a *hypothec*), the Russian Federation (First Part of 1994) and Hungary (1959, articles 251-269 revised in 1996), as well as by the Estonian Property Law of 1993 and the Ukrainian Law on Pledges of 1992.

27. Also the Chinese law on guarantees (1995) falls into this group since it covers neither assignments nor pledges of receivables nor reservations of title. Assignments are dealt with by the contract law of 1999 (articles 79-83). Registration under the law of 1995 is obligatory only for major items of collateral; for other items it is optional.

28. In November 1999, the Government of Viet Nam adopted a decree on secured transactions which complements the rules on secured transactions contained in the civil code adopted in 1994. The combined effect of the rules on secured transactions in the civil code and the decree is that a pledge or mortgage can cover property, both presently owned and acquired after the conclusion of a security agreement, to secure the performance of present and future obligations. The decree also permits a non-possessory pledge or mortgage, but such security becomes enforceable against third parties including subsequent secured creditors only upon registration of a notice of the security with the appropriate registration agency in Viet Nam. In addition, the decree regulates the enforcement of secured transactions including self-help (i.e. enforcement without recourse to courts). The Government of Viet Nam announced that it will adopt a decree on registration of secured transactions by the end of 2000. The proposed decree would set forth the rules governing the establishment of a computerized "notice filing" system (i.e. a system for registration of a notice with limited data about a secured transaction).

C. Laws governing only major non-possessory security interests

29. Several countries have enacted statutes covering non-possessory security interests. Excluded in those countries are reservations of title and leases that function economically as security for the purchase price of the goods rather than as an exchange of money for temporary possession of the goods. In some countries, possibly even security for financing, such as the unregistered security transfer of ownership, may coexist with the new non-possessory security interest which requires registration. As far as the theoretical approaches of these statutes are concerned, two different methods are used, one based on the idea of pledge, the other on the idea of *la propriété-sûreté* (or fiduciary transfer), namely full transfer of title in the collateral to the secured creditor.

1. The pledge approach

30. The pledge approach has been used widely, especially in the new laws on non-possessory pledge enacted in Bulgaria (1996), Chile (1982), Latvia (1998), Lithuania (1997) and Poland (1996). Most of those countries provide for registration of the creditor's interest. By contrast, under Chilean law, effects vis-à-vis third persons depend upon publication of an extract of the security agreement in the official gazette.

31. Virtually the same effect is achieved in Italy by article 46 of the banking law (1993) for securing medium and long-term bank credits to enterprises if the collateral is not subject to registration. This security, called a privilege, confers upon the bank a preferential claim for satisfaction from the collateral. The privilege must be registered in the enterprise registry and must also be published in the official gazette. The pledge approach commends itself in particular for countries which have new, more comprehensive legislation covering also the traditional possessory pledge.

2. Fiduciary transfer of title

32. The method of a fiduciary transfer to the creditor of title in the collateral has been used by special laws enacted in Brazil (1965), Indonesia (1999) and Montenegro (1996). Generally speaking, the creditor, as fiduciary owner, is subject to rules which in essence hardly differ from corresponding rules established for secured creditors under the pledge approach. In particular, after the debtor's default the fiduciary owner is not allowed to simply appropriate the collateral into full ownership, but must follow rules which correspond to those for the enforcement of a non-possessory pledge.

D. Laws on more global security devices, especially enterprise mortgages

33. It is a central feature of modern legislation on security interests to enable the creation of security interests in a fund with changing contents, especially the debtor's inventory. This purpose can be achieved by softening the rules on specific description of a security interest or by institutionalizing the "enterprise" as a specific type of collateral. In contrast to traditional restrictive models, Sweden and Finland in 1984 and Estonia in 1996 have enacted special laws on enterprise mortgages which, like the English floating charge, allow coverage of virtually all movable assets of an enterprise.

E. Laws on purchase money security devices

34. There is little economic difference between a loan to a debtor (by the seller of goods or a separate lender), enabling the debtor to purchase goods which are, by agreement, collateral for the loan, and the sale of those goods by the seller on credit terms in which the seller retains rights with respect to the goods until the price is paid. However, most legal systems have treated these two models differently. Traditionally, the seller who, has credited the purchase price to its buyer, enjoys special protection of one sort or another. Under most civil codes, the seller is protected by a right of retention of title or enjoys a preference for its claim to the purchase price. Civil codes of the 20th century often allow the seller to retain title to the sold goods until payment of the purchase price (e.g. Dutch civil code, book 3 (1992); Peru (1984); Portugal (1967); Québec (1992); Russian Federation (Part II, 1996); and China, contract law (1999)). By contrast, Paraguay allows merchants to secure purchase money by agreeing upon a non-possessory registered pledge (civil code 1985). If the goods sold are subject to registration, the retention of title must be registered; in other cases, the retention of title clause may be subject to a special form.

35. In most European countries, the seller as owner is entitled to demand return of the sold goods if the buyer, by non-payment of the purchase price, breaches the contract of sale. Usually this is also possible in the buyer's insolvency. Some countries have expressly given effect to, or regulated the exercise of, this right in the buyer's insolvency (e.g. France (1985) and Belgium (1999)). In countries which have introduced a unified security interest (see paras. 24 and 25), an agreement that the unpaid seller will retain title is limited in effect to retention of the unified security interest. However, in all of these countries, such a security interest serving to secure purchase money enjoys a preferred status as against competing non-purchase money interests.

F. Laws governing assignment of receivables

36. Some European countries have amended their laws or enacted new legislation in order to adapt their rules regarding assignments of receivables to modern demands for the financing of enterprises. In particular, the requirement of notifying the debtor as a condition for giving effect to the assignment vis-à-vis third parties has been abolished, either almost completely (Belgium 1998) or replaced by a less burdening device at least for the use of receivables arising from transactions between merchants as collateral for bank credits (France 1981).

IV. TRENDS

A. National level

37. There is a clear trend towards stressing the importance of an adequate legal regime for non-possessory security. Less prevalent, so far, though, have been legal regimes that bring about the generalization of non-possessory security, that is, allowing use of these devices not only by special groups of creditors or debtors or in specific items of collateral, but by all creditors and in all collateral. However, a trend in this direction is discernible. Modern laws on non-possessory security also seek to make security available for medium and long-term credits for financing not only in connection with the acquisition of individual equipment, but also with the current business affairs of the debtor. Security of a more permanent character in a changing pool of assets (such as inventory, raw materials, semi-finished goods or receivables) can only be preserved if the idea of a fund with changing elements (such as inventory) is accepted. The clearest, although arguably extreme, expression of this principle is the concept of security in a whole enterprise or defined parts of it. An alternative (or supplementary) idea is that security may be extended into proceeds or products of the original collateral.

38. Most new legislation also accepts, at some level, the idea of registration of non-possessory security interests as a means of giving publicity. However, the forms and especially the content of the data to be registered vary considerably. Occasionally other forms of publicity have been chosen, such as publication in an official gazette. The issue whether unpaid sellers should be protected by being allowed to retain title or by being referred to a non-possessory pledge is still solved quite differently in different countries. However, there is broad agreement that such sellers should benefit from special protection in the case of conflicts of priority, even if their retention of title is limited in effect to a pledge.

B. International and regional levels

39. The problem of assuring the preservation of security rights in collateral used in border-crossing trade has so far been addressed only for special items. It should be noted that, in countries following civil law models, the issue hardly arises in receivables because these usually are considered to be stationary. For high-value mobile equipment, the Unidroit preliminary draft Convention should solve the cross-border problem, since it specifically addresses the movement of these assets across national borders. By contrast, security interests in other goods and assets are not specifically protected against loss which may result from their movement into another jurisdiction. The sellers of export goods and their financiers are particularly exposed to this risk.

V. NEED FOR FURTHER WORK

40. While, as the preceding survey demonstrates, much has occurred in the law of secured credit over the last twenty-five years, it would not be accurate to conclude that the international legal situation is one that is conducive to the efficient and effective extension of secured credit. Rather, there are significant problems that impede this mechanism to make credit more easily available at lower cost.

A. Current problems

1. Inadequate domestic law

41. In many situations, the most significant impediments to international secured transactions arise not from the differences between the secured credit laws of the States involved but, rather, from the fact that domestic legal systems governing secured credit are simply inadequate to support the extension of credit at lower costs. While these systems may perhaps be justified on grounds other than efficacy in enabling the extension of such credit, their effect on a credit economy cannot be understated. The problems from such systems can arise from a variety of causes:

(a) There may be limits on the situations in which non-possessory security interests may be used. Such limits may relate to the identity of the debtor or of the creditor, or to the nature of the collateral.

(b) There may be uncertainty resulting from the lack of comprehensive rules that resolve, in a predictable way, issues that are likely to arise in secured transactions. While some legal systems have extensively developed laws governing secured transactions, other systems have only skeletal rules. While skeletal rules have some advantages, there is an uncertainty cost associated with them.

(c) There may be problems associated with rules that inhibit the creditor's practical ability to utilize the value of the collateral to obtain satisfaction after the debtor's default. This can occur in several ways, including:

(i) There may be rules that make it inordinately difficult for the creditor to obtain possession of the collateral from the debtor within a reasonable period of time, thus adding to the creditor's expenses and increasing the likelihood that the value that can be obtained from the collateral will decrease because of depreciation.

(ii) There may be rules that make it inordinately difficult for the creditor to dispose of the collateral at the highest possible price.

(d) The absence of rules that enable creditors to determine the status of their rights as against other potential claimants of the collateral (i.e. priority) before extending credit.

2. "Friction" resulting from the possibility that more than one country's law might govern

42. The domestic law governing secured credit varies greatly from country to country. The result of this variation is to increase the cost or decrease the availability of secured credit across national borders. Such increased costs (which may result in decreased availability of credit because the costs would make the extension of credit unprofitable for the party that bears them) are of several varieties:

(a) The cost of obtaining understanding of the secured credit law of more than one jurisdiction. In any transaction in which the law of more than one State might apply, a prudent party must ascertain the law of all relevant States. While such a party may be quite familiar with the legal terrain in the State or States of its principal operations, it is unlikely to be aware of the laws of other States with a similar degree of familiarity.

(b) The cost of determining which jurisdiction's law is likely to govern. If more than one jurisdiction is involved, and the law of the relevant jurisdictions differs with respect to important issues relating to the rights of parties with respect to the transaction, this choice of law determination is essential to identification of those rights. In most cases, such a determination must be made in advance, or the creditor will be unwilling to extend credit.

(c) The cost associated with the inability to determine definitively which jurisdiction's law will govern various aspects of the transaction. Despite the importance of the choice of law determination, there will be many cases in which the determination cannot be made in advance with any degree of certainty. Unfortunately, choice of law rules differ significantly from jurisdiction to jurisdiction, so that the choice of law principle that may be applied to a particular transaction may depend on the location of the forum. Moreover, in some jurisdictions, it may be difficult to ascertain in advance the choice of law rule that might be applied.

3. Loss of security if collateral crosses national borders

43. In many cases, due to divergent national regimes governing secured credit, the continued existence of a security interest, validly created in one country, is denied in another country if the collateral is moved from the first country to the second country. This problem causes particular difficulty in the case of collateral which, by its nature, crosses national borders, such as export goods or trucks.

B. The case for further work

44. Through its continuing work on the draft Convention on Assignment of Receivables (see para. 6), UNCITRAL has recognized the advantages of facilitating the development of legal regimes that increase the availability of credit at lower cost. Moreover, in the context of developing that draft Convention, UNCITRAL has more specifically recognized the role played by personal property as collateral in increasing the availability of credit at lower cost. Thus, UNCITRAL may logically extend its work to more comprehensive efforts in the area of personal property security.

45. The benefits from further work in this field can be of two types. First, by lessening the "friction" between national legal systems and helping to improve domestic law, UNCITRAL can help ease the difficulties described above that inhibit the possibility of extending greater amounts of credit at lower cost at both the domestic and international levels. Second, as studies of the World Bank indicate (see para. 17), modernization and optimization of secured credit law can lead to expanded economic development and, therefore, promote the general welfare.

VI. POSSIBLE FUTURE EFFORTS BY UNCITRAL

A. A convention unifying substantive rules governing security interests

46. Complete unification of the substantive rules governing security interests in the world's nations could be brought about only by a convention binding upon all Contracting States. Such a convention, by establishing a high and uniform standard, would remedy the inadequacies of many national legal systems mentioned in paragraph 41 and would facilitate the extension of secured credit across borders, thus overcoming the obstacles mentioned in paragraphs 42 and 43. However, at present the national legal systems are still too divergent, both in terms of the legal techniques used and of the substantive solutions, to offer a realistic chance of adoption of such a convention by many countries. Also, a convention would not be flexible enough to take into account the varying circumstances of the countries of the world, including their systems of substantive and procedural law.

B. A convention establishing uniform conflict rules

47. A project leading to a convention that would, nonetheless, be much less ambitious than the unification of the substantive law of security interests would be a project limiting itself to establishing some uniform conflicts rules for security interests. Such a convention could address the present shortcomings identified in paragraph 42. Conflicts rules may be more acceptable to States since they do not, as a rule, affect the national legal regimes. Moreover, there is already a common basis on which to begin such work; the principle of the lex situs is recognized in most jurisdictions as governing many rights in movables. Yet, there are variations as to the extent to which this principle governs. In addition, some deviations from this principle will be necessary, especially for means of transport and other mobile goods, and rules for intangibles may follow other organizing principles (see articles 24-26 and 28-31 of the UNCITRAL draft Convention on Assignment of Receivables). However, the major difficulties arising in the context of the cross-border movement of collateral cannot be solved by adequate conflicts rules alone. Because of widely diverging national regimes (see paragraph 41), after collateral has been moved to another country and, therefore, may become subject to the new lex situs, it may be necessary to requalify the imported foreign security interest and adapt it to the new national regime. This is difficult if the two countries involved use very different techniques; or even if the techniques are similar, the country to which the collateral has moved establishes requirements going beyond those of the original country, for example, demands a "certain date" for the underlying agreement, or registration. To some degree, such difficulties can be surmounted by providing grace periods for adaptation, or requiring the contracting parties to amend and adapt their contract and/or the security to the requirements of the new lex situs.

C. A convention or model law creating an international security interest

48. Rather than creating law for domestic transactions, it might be possible to create "international interests" in certain types of collateral (see para. 9). A benefit to be derived from such an approach is that the interest that would be created would have its own body of substantive law. There are also disadvantages to such an approach, though. For one, a body of law that would apply only to an interest created in an international transaction would, by its nature, inevitably coexist awkwardly with domestic law governing similar transactions that have no international component. For example, in a priority dispute between two claimants, one with an international interest and the other with an entirely domestic interest, difficult choices would need to be made concerning the legal regime that governed. If, despite such obstacles, creation of one or more international interests were to be undertaken, a determination would be required whether to proceed by way of a convention or by way of a model law. A convention to which States accepting the concept of the international interest would become Contracting States would appear feasible, but a model law might serve the same purpose as between States that have adopted it.

D. A statement of principles accompanied by a model law

49. A more realistic solution might consist of a model law which, by its nature, would not require countries to accept or reject it as a whole. With this limitation in mind, the greatest possible benefit would be brought about by a comprehensive law. The product could have two parts. The first part would be a statement of principles for secured credit systems, explaining the structure of the relationships between the debtor and the secured creditor and between the secured creditor and other possible claimants to the collateral and indicating why particular structures can facilitate extension of credit while protecting debtors' rights in the event of default. The second part would be a model law embodying those principles and applying to security interests in all types of personal property, regardless of the form of the transaction.[28] Both the envisaged principles and the model law might also deal with the problems of cross-border movement of collateral, along the lines mentioned in paragraph 43.

50. A comprehensive model law, as opposed to model laws for specific types of transactions or collateral, has the potential to bring about the greatest possible benefit. It would create the conditions for a domestic credit economy in nations enacting it and, to the extent that the model law is adopted by many nations, the resulting harmonization would reduce the "friction" costs and substantive obstacles resulting from differing legal regimes in international transactions. However, to the extent that such a model law would need to reflect certain fundamental guiding principles that would not be common ground to all legal systems, it would represent a significant change from current law in many countries and may, as a result, not be sufficiently acceptable. It may, therefore, be necessary to envisage a model law with alternative provisions.

E. More limited solutions

1. Narrower substantive model laws

a. *Particular types of collateral*

51. A possible alternative to the preparation of a comprehensive model law governing all aspects of secured credit could be the promulgation of discrete model laws for specific transactions or types of collateral. This result could be brought about either by drafting separate model laws or by extracting the relevant portions from a comprehensive model law. Types of collateral that could be separately treated in this way might include, for example, investment securities or goods (or even a subset of goods such as inventory or business equipment).

52. The production of narrower model laws in place of (or as an alternative to) a comprehensive model law may have great advantages in terms of acceptability. By providing model laws limited in scope to a particular type of collat-

[28] The experience gained in the context of the preparation of the Model Law and the core principles by the EBRD (see para. 16) could provide useful guidance.

eral or transaction, it might be easier for a country to adopt one or more such laws. For example, in the particular case of security interests in investment securities, there is relatively little developed law in most countries. Thus, such a limited model law could provide support for increased access to credit in this area. The work of the European Union provides useful precedent of this approach (see paras. 11 and 12). On the other hand, by promulgating model laws limited in scope to a particular type of collateral, one might increase the chance of some enactments but miss the chance to accomplish broader substantive reform.

b. *Model rules governing specific aspects of secured credit*

i. *Model rules for priority systems based on filing/registration*

53. Many countries base all or part of their priority systems for secured credit on the order of filing or registration of information concerning a security interest, or are considering establishment of such priority systems. Yet, the rules governing such systems vary significantly from country to country and the operational details of such systems also vary quite substantially. Model rules in this regard could assist countries in devising and maintaining the best possible priority systems of this type and lead to greater uniformity across borders, as well as lower transaction costs.

ii. *Model rules for repossession and disposition of collateral*

54. Collateral securing a debt will not lower the cost of credit unless, upon the debtor's default, the collateral can be efficiently taken and disposed of to generate the funds to fulfil the debt. After all, the purpose of collateral is to create a potential source of fulfillment of the debtor's obligations that the creditor will be able to turn to in the event of the debtor's default. While debtors must be protected against abusive foreclosure practices and collusive dispositions, protection that makes it inordinately difficult to convert the collateral to cash for application to the secured debt may be illusory because the resulting system might not generate credit. This will occur if those protections significantly lessen the likelihood that the funds generated from the collateral can contribute materially to fulfillment of the debtor's obligations. A model law with rules for repossession and disposition of collateral could serve an important role for countries that would like to reform their post-default procedures.

2. Conflict-based solutions

55. In international secured transactions, uncertainty as to which country's law will govern often adds to the cost of a transaction. At the very least, the cost of ascertaining the law that is most likely to govern will often be non-trivial and thus will be a cost that must be borne by the transaction. Moreover, agencies that rate large transactions report that, because of the uncertainties as to which country's law will govern, they typically assume that the law that is least advantageous for a transaction will govern it rather than speculate as to which law will govern. In the absence of substantive harmonization, conflict-based solutions, if achievable, could reduce some of these costs. While a model law might be possible in this area, it would appear that conflict-based solutions should be in the form of conventions.

a. *Tangible property*

56. With limited exceptions discussed below, conflict-based solutions for tangible property do not seem to show much potential for further work. After all, the lex situs principle is so well established, at least for priority matters, as to not leave much room here. Even the recent revision of UCC Article 9 in the United States, which departs from lex situs in the context of "perfection" (i.e. effectiveness as against third parties), reverts to it in the more important context of priorities.

i. *Recognition of established interests*

57. One limited area in which a conflict-based solution might provide some value is in the context of situations in which an enforceable interest in personal property securing a debt is created as between debtor and creditor in one country, after which the debtor moves the collateral to a different country that does not recognize the interest created in the first country. An example is provided by a floating charge on goods in England that are later moved to France, which does not recognize the rights associated with an English floating charge. A conflict-based solution could provide that, as between the parties (and, perhaps, to some extent with respect to those who derive their interest in the collateral from the debtor), the interest created in the first country will be recognized in the second country.

ii. *Recognition of established priorities*

58. In the same spirit as the point made in paragraph 57, it can be argued that international stability of security interests would be increased by providing that, if two creditors in the original country both have security interests in the same item of collateral, their relative priority should not change simply because the collateral has been moved to a different country. Thus, a conflict-based solution could provide that, as between competing secured parties (and, perhaps, to some extent with respect to those who derive their interest in the collateral of one of those parties), priorities established in the original country would be respected in the second country.

b. *Intangible property*

59. The class of intangible property that most often serves as collateral is receivables. That property is the subject of the draft Convention now being completed by UNCITRAL (see para. 6), which contains both substantive and conflict-based solutions (see A/CN.9/470). There are, however, two other types of intangible property worthy of some thought for a conflicts-based solution.

i. *Investment securities*

60. In recent years, investment securities have been transformed in many countries from quasi-tangible property memorialized in a certificate to intangible property representing a claim against a securities intermediary. Inasmuch as the law governing interests in investment securities as collateral varies significantly from country to country, a conflict-based solution could provide some certainty here by providing which country's law would govern international interests in such securities.[29]

ii. *Intellectual property*

61. Intellectual property represents an emerging class of intangible property that could probably benefit from increased certainty as to which country's law governs and, therefore, a conflicts-based solution seems appealing on the surface. Yet, as this class of property is developing and changing rapidly in response to new information technologies, any effort undertaken at this time would likely be premature, a fact that counsels against instituting such a project at this time.

3. A statement of principles accompanied by a legal guide

62. This approach is a variation of, and could be combined with, the approach discussed in paragraphs 49 and 50. A model law would be more desirable from the point of view of completeness and uniformity. If, however, the preparation of such a model law proves to be impossible, the preparation of a set of key objectives and core principles for an efficient legal regime governing secured credit along with a legislative guide (containing flexible approaches to the implementation of such objectives and principles, and a discussion of alternative approaches possible and of the perceived benefits and detriments of such approaches) would still be sufficiently useful to justify future work.

VII. CONCLUSIONS

63. With its work on assignment law (see para. 6), the Commission made a first step towards facilitating credit at more affordable rates and creating a level playing field for business parties in international commerce, at least with regard to access to lower-cost credit. In addition, in the last twenty-five years, significant developments have taken place in that direction, both at the national and the international level. However, secured credit law in much of the world is still not conducive to the efficient and effective extension of secured credit. Inadequate domestic law, friction resulting from the possibility that more than one country's law might apply and loss of security if collateral crosses national borders continue to impede international commerce (see paras. 41-43), while creating a competitive disadvantage for business parties who do not have sufficient access to lower-cost credit. In view of this situation, the Commission may wish to draw the conclusion that further work in the field of secured credit law would be highly desirable.

64. While there are many areas in which further harmonization of secured credit law would be beneficial, a decision as to which areas to select requires that thought be given to practical considerations. In determining whether particular projects are appropriate for treatment in the near future, the Commission may wish to consider, inter alia: whether the subject of the proposed project is ripe for articulation in the form of law; whether it is possible to prepare the product in a reasonable period of time; and what is the likelihood of any product becoming acceptable to States and to participants in international commerce. Taking into account those considerations, the experience gained by the Commission in its work on assignment law (see paras. 6, 44 and 45) and the various possible solutions discussed in the present report (see paras. 46-62), the Commission may, subject to further consideration, wish to draw the following tentative conclusions:

(a) At the present time, the preparation of a convention unifying substantive rules governing security interests would in all likelihood not be feasible, in particular in view of the wide divergences existing among legal systems and the complexity of the issues involved in secured credit law (see para. 46).

(b) An acceptable convention establishing uniform conflict rules could probably be prepared (see para. 47). However, the usefulness of such a convention may be limited, if it is not supplemented by substantive law rules, since the problems identified in the present report (see paras. 41-43) could not be resolved by conflict rules alone.

(c) A model law or a convention establishing a new, international security interest, which would coexist with domestic security interests, might usefully be prepared, provided that its scope would be limited to certain types of collateral (see para. 48).

(d) A statement of principles accompanied by a comprehensive model law would be both desirable and feasible, in particular if the model law would include alternative provisions to the extent necessary (see paras. 49 and 50).

(e) In contrast to a comprehensive model law that would apply to all types of asset, discrete model laws governing certain types of asset or specific aspects of secured credit law may be less desirable but more feasible, in particular with respect to certain types of collateral, such as investment securities (see paras. 51-61 and 66).

(f) A statement of principles accompanied by a guide would probably be a text with the highest degree of feasibility at the present time (see paras. 62 and 65). Such a project would also be sufficiently useful. Whether it would be feasible to prepare, in addition to the principles, a comprehensive model law could be considered in the context of the preparation of the principles.

[29] See article 9 (2) of European Union Directive on Settlement Finality, referred to in paragraph 12.

65. With regard to the preparation of a set of principles with a legislative guide in particular, the Commission may wish to note that any work to be undertaken could draw on work by the Commission on assignment of receivables and by other organizations, such as EBRD, the World Bank, ADB, OAS and IBA, in other relevant areas (see paras. 15-18 and 20), as well as on any work the Commission may wish to undertake in the field of insolvency law (see A/CN.9/469, para. 140). In fact, as the work undertaken by the World Bank and ADB shows (see paras. 17 and 18), any principles that the Commission may wish to prepare on insolvency law would necessarily deal with the treatment of security interests in the case of insolvency and make assumptions with regard to core principles of an efficient secured transactions law that would be compatible with any insolvency law principles to be prepared by the Commission. As a result, the considerations of the Working Group on Insolvency Law would be relevant and could assist in establishing the feasibility of the Commission preparing a set of principles for an efficient secured transactions law. In its consideration of the matter, the Commission may wish to take into account that parallel work by the Commission in the areas of secured transactions and insolvency law could ensure compatibility between any principles on insolvency and secured transactions law and, as a result, an appropriate balance among the interests of preferential, secured and unsecured creditors.

66. Furthermore, with regard to work aimed at the preparation of uniform rules for specific transactions or specific collateral, such as investment securities, the Commission may wish to note that any work to be undertaken could usefully draw on the work by other organizations, in particular by the European Union with the assistance of organizations such as ISDA (see paras. 11 and 12 and footnote 20), as well as on any work to be undertaken by the Commission on insolvency law. A text on security interests in investment securities could establish a new international interest (see para. 48) and address, inter alia, conflict-of-laws issues (see para. 60).

67. With a view to further establishing the feasibility of the work mentioned in paragraphs 65 and 66 and identifying in more detail the relevant problems and the possible solutions, the Commission may wish to request the secretariat to prepare a study for submission at the thirty-fourth session of the Commission. The study could examine, in particular, whether current trends establish sufficient common ground among the various legal systems and economies at different levels of development to warrant further work by the Commission. The study could also discuss the advantages and disadvantages of a comprehensive model law on security interests, a model law on particular types of collateral, such as investment securities, and a set of principles, possibly with a guide and general legislative recommendations. The study could also draw and build on the work completed, underway or announced by other organizations, including Unidroit, the European Union, OAS, EBRD, the World Bank, ADB, IBA, ICC and ALI. On the basis of that study, the Commission may wish to decide, at its thirty-fourth session, whether to undertake any further work in the field of secured credit law.

D. Transport Law: possible future work: Report of the Secretary-General

(A/CN.475) [Original: English]

CONTENTS

I. INTRODUCTION

1. When considering future work in the area of electronic commerce, following the adoption of the UNCITRAL Model Law on Electronic Commerce at its twenty-ninth session, in 1996,[1] the United Nations Commission on Trade Law considered a proposal to include in its work programme a review of current practices and laws in the area of the international carriage of goods by sea, with a view to establishing the need for uniform rules where no such rules existed and with a view to achieving greater uniformity of laws.[2]

2. The Commission was told that existing national laws and international conventions left significant gaps regarding issues such as the functioning of bills of lading and seaway bills, the relation of those transport documents to the rights and obligations between the seller and the buyer of the goods and the legal position of the entities that provided financing to a party to the contract of carriage. Some States had provisions on those issues, but the fact that those provisions were disparate and that many States lacked them constituted an obstacle to the free flow of goods and increased the cost of transactions. The growing use of electronic means of communication in the carriage of goods further aggravated the consequences of those fragmentary and disparate laws and also created the need for uniform provisions addressing the issues particular to the use of new technologies.

3. It was then suggested that the secretariat should be requested to solicit views and suggestions on those difficulties not only from Governments but in particular from the relevant intergovernmental and non-governmental organizations representing the various interests in the international carriage of goods by sea. An analysis of those views and suggestions would enable the secretariat to present, at a future session, a report that would allow the Commission to take an informed decision as to the desirable course of action.

4. Several reservations were expressed with regard to the suggestion. One was that the issues to be covered were numerous and complex, which would strain the limited resources of the secretariat. Priority should instead be given to other topics that were, or were about to be, put on the agenda of the Commission. Furthermore, it was said that the continued coexistence of different treaties governing the liability in the carriage of goods by sea and the slow process of adherence to the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules) made it unlikely that adding a new treaty to the existing ones would lead to greater harmony of laws. Indeed, there was some danger that the disharmony of laws would increase.

5. In addition, it was said that any work that would include the reconsideration of the liability regime was likely to discourage States from adhering to the Hamburg Rules, which would be an unfortunate result. It was stressed that, if any investigation was to be carried out, it should not cover the liability regime. It was, however, stated in reply that the review of the liability regime was not the main objective of the suggested work; rather, what was necessary was to provide modern solutions to the issues that either were not adequately dealt with or were not dealt with at all in treaties.

6. Having regard to those differing views, the Commission did not include the consideration of the suggested issues on its agenda at that stage. Nevertheless, it decided that the secretariat should be the focal point for gathering information, ideas and opinions as to the problems that arose in practice and possible solutions to those problems. Such information-gathering should be broadly based and should include, in addition to Governments, the international organizations representing the commercial sectors involved in the carriage of goods by sea, such as the Comité maritime international (CMI), the International Chamber of Commerce, the International Union of Marine Insurance, the International Federation of Freight Forwarders Associations, the International Chamber of Shipping and the International Association of Ports and Harbors.

7. At its thirty-first session, in 1998, the Commission heard a statement on behalf of CMI to the effect that it welcomed the invitation to cooperate with the secretariat in soliciting views of the sectors involved in the international carriage of goods and in preparing an analysis of that information. That analysis would allow the Commission to take an informed decision as to the desirable course of action.[3] Strong support was expressed at that session for the exploratory work being undertaken by CMI and the secretariat of the Commission. The Commission expressed its appreciation to CMI for its willingness to embark on that important and far-reaching project, for which few or no precedents existed at the international level.[4]

8. At the thirty-second session of the Commission, in 1999, it was reported on behalf of CMI that a CMI working group had been instructed to prepare a study on a broad range of issues in international transport law with the aim of identifying the areas where unification or harmonization was needed by the industries involved. In undertaking the study, it had been realized that the industries involved were extremely interested in pursuing the project and had offered their technical and legal knowledge to assist in that endeavour. Based on that favourable reaction and the preliminary findings of the working group, it appeared that further harmonization in the field of transport law would greatly benefit international trade. The working group had found a number of issues that had not been covered by the current unifying instruments. Some of the issues were regulated by national laws that were not internationally harmonized. Evaluated in the context of electronic commerce, that lack of harmonization became even more significant. It was reported that the working group had identified numerous interfaces between the different types of contracts involved in international trade and transport of

[1] *Official Records of the General Assembly, Fifty-first Session, Supplement No. 17* (A/51/17).

[2] Ibid., para. 210.

[3] *Official Records of the General Assembly, Fifty-third Session, Supplement No. 17* (A/53/17), para. 264.

[4] Ibid., para. 266.

goods (such as sales contracts, contracts of carriage, insurance contracts, letters of credit, freight forwarding contracts and a number of other ancillary contracts). The working group intended to clarify the nature and function of those interfaces and to collect and analyse the rules currently governing them. That exercise would at a later stage include a re-evaluation of principles of liability to determine their compatibility with a broader area of rules on the carriage of goods.[5]

9. It was also reported at the thirty-second session of the Commission that the working group had sent a questionnaire to all CMI member organizations covering a large number of legal systems. The intention of CMI was, once the replies to the questionnaire had been received, to create an international subcommittee to analyse the data and find a basis for further work towards harmonizing the law in the area of international transport of goods. The Commission had been assured that CMI would provide it with assistance in preparing a universally acceptable harmonizing instrument.[6]

10. At its thirty-second session, the Commission had expressed its appreciation to CMI for having acted upon its request for cooperation and had requested the secretariat to continue to cooperate with CMI in gathering and analysing information. The Commission was looking forward to receiving a report at a future session presenting the results of the study with proposals for future work.[7]

11. The purpose of the present report is to apprise the Commission of the work that has been carried out thus far by CMI, in cooperation with the secretariat of the Commission, since the thirty-second session of the Commission. The information is intended to facilitate the Commission's decision on the nature and scope of any future work that might usefully be undertaken by it.

II. PROGRESS OF THE WORK OF THE COMITÉ MARITIME INTERNATIONAL

12. In cooperation with the secretariat of the Commission, CMI undertook to organize a broad investigation of views and suggestions relating to practical problems and possible solutions to those problems. The CMI Executive Council set up a Steering Committee to consider the project. The Steering Committee issued a report dated 29 April 1998[8] in which it outlined the work that should be undertaken by a working group. An international working group was then established; it studied the issues outlined in the Steering Committee's report and drew up a questionnaire that was sent to all national maritime law associations in May 1999.

13. The questionnaire covered the following issues: *(a)* inspection of the goods and description of the goods in the transport document; *(b)* transport document (date, signature and statements in the transport document, other than for description of the goods); *(c)* rights of the carrier (freight, deadfreight, demurrage and other changes and lien); *(d)* obligations of shipper, intermediate holder and consignee; *(e)* delivery and receipt of the goods at destination; and *(f)* rights of "disposal".

14. The Executive Council of CMI established an international subcommittee on issues of transport law in which delegations from all national maritime law associations, as well as the international organizations involved in trade and shipping, were invited to participate. The International Subcommittee met in London on 27 and 28 January 2000; it is scheduled to meet again in London on 6 and 7 April 2000 and in New York on 7 and 8 July 2000. From the beginning of the project, there were consultations with the different sectors of industry in the form of round tables and bilateral meetings.

III. OVERVIEW OF ISSUES AND STAGE OF CONSIDERATION OF POSSIBLE SOLUTIONS

15. At its first meeting, the International Subcommittee discussed the six issues referred to in paragraph 12 above. Under its terms of reference, the International Subcommittee is required to prepare an outline of an instrument designed to bring about uniformity in transport law. The first meeting identified issues that such an instrument could resolve.

16. The paragraphs below present a summary of the information reviewed by the International Subcommittee at its first meeting concerning the state of the law with respect to those six topics and possible solutions that, as agreed at the first meeting of the International Subcommittee, are being put forward by the working group for discussion at the second meeting of the International Subcommittee. In the paragraphs below, references to countries are to the countries of the national maritime law associations and national members of other organizations that provided replies to the questionnaire. The replies are available on the CMI web site *(www.comitemaritime.org).*

A. Inspection of the goods and description of the goods in the transport document

17. When the carrier or the actual carrier takes the goods in its charge, the carrier must, on demand of the shipper, issue to the shipper a bill of lading that should state, inter alia, the general nature of the goods, the leading marks necessary for identification of the goods, an express statement, if applicable, as to the dangerous character of the goods, the number of packages or pieces, the weight of the goods or their quantity otherwise expressed (all such particulars as furnished by the shipper) and the apparent condition of the goods (see the International Convention for the Unification of Certain Rules relating to Bills of Lading (Hague Rules), art. 3, para. 3, subpara. *(b);* the Hague Rules as Amended by the Brussels Protocol 1968 (the Hague-Visby Rules), art. 3, para. 3, subparas. *(b)* and *(c);* and the United Nations Convention on the Carriage of Goods by Sea, 1978 (the Hamburg Rules), art. 15, para. 1, subparas. *(a)* and *(b)*).

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

[6]Ibid., para. 415.

[7]Ibid., para. 418.

[8]*CMI Yearbook 1998*, pp. 108-117.

18. The issue arises as to the extent to which the carrier is responsible for inspecting goods carried, in particular in situations where actual inspection may not be physically reasonable or economically feasible, such as in carriage of bulk cargo, containerized goods, carriage of numerous small items, technical cargo or where no weighing facilities are available at the load port. Another issue is to what extent the details provided in the transport document should be prima facie evidence of that information, in particular in situations where such information is received by electronic means from the shipper.

19. The responses to the CMI questionnaire revealed considerable consistency in the approach to this issue. Goods are taken to be in good "apparent" order and condition as determined by external visual inspection (in Australia, Canada, China, Hungary, Italy, Japan, the Netherlands, New Zealand, Norway, Spain, Turkey, the United Kingdom of Great Britain and Northern Ireland and the United States of America), without interfering with the packing (in Canada), also taking into account, as specified in some legal systems, other elements such as weight (in Australia and Japan), noise and smell (in Japan), and mate's receipts (in New Zealand). In Poland the test is one of good faith: it is assumed that the carrier had no knowledge (despite the exercise of due diligence) that the goods were shipped in a condition other than as described in the bill of lading. In Indonesia it appears that the word is understood as meaning that the carrier has received the goods in order and good condition, having "checked and rechecked" the condition of the goods.

20. A carrier has no reasonable means of checking particulars provided by a shipper where the goods are containerized and have been packed by the shipper (in Argentina, Australia, Indonesia, the Netherlands, Norway, the United Kingdom and the United States), for bulk goods (in Italy and the Netherlands) except for weight and survey reports (in China), for packed goods in general (in the Netherlands), for technical cargo (in Norway), where it is uneconomical to tally the cargo (in Italy and the Netherlands) or where no weighing facilities are available (in the United States).

21. The general position is that the carrier may refuse to insert information in a bill of lading where it is obviously incorrect (in Australia, Canada, the Netherlands, Norway, Spain and the United States) or where it has reason to believe that the information is incorrect (in Australia, Canada, Norway, Spain and the United States). However, in Italy the carrier may only refuse to insert information in a bill of lading that it has actually found to be incorrect.

22. At the first meeting of the International Subcommittee there was agreement that, when the carrier had reasonable grounds for suspecting that the information furnished by the shipper did not accurately represent the goods, the carrier was obligated to check the information if it had a reasonable means of doing so. Thus the carrier would be excused from including the otherwise required information only when there was no reasonable means of checking it.

23. Other issues considered by the International Subcommittee included the conditions under which a carrier could protect itself by omitting from the transport document a description of the goods that it was unable to verify (for instance, by inserting clauses such as "said to contain" and "shipper's weight and count"), the effects of qualifying clauses in transport documents and the desirability of developing harmonized provisions regulating the use and effects of such clauses, taking into account their practical implications in respect of containerized transport.

B. Transport document

24. While article 16 of the Hamburg Rules lists certain minimum information that the bill of lading is required to contain, this question is left largely open under the Hague-Visby Rules, which, in particular, make no reference to date and signature of the bill of lading or methods for identifying the carrier. The content of the bill of lading and the consequences of missing or inaccurate information are thus largely left for domestic law.

1. Date

25. Dating of the transport document is at present either mandatory (in Argentina, China, the Democratic People's Republic of Korea, Germany, Indonesia, Lebanon, the Netherlands, Norway, Poland, Spain and Turkey) or, while not mandatory, common practice (in Australia, Canada, New Zealand, the United Kingdom and the United States), usually in order to satisfy the requirements of banks issuing letters of credit.

26. The applicable date is the date of signature of the bill of lading (in the Democratic People's Republic of Korea, Italy, Japan and the Netherlands), the date of issue (in Germany and Poland), the date of receipt or loading on board (in Australia, Canada, China, Italy, Japan, New Zealand, Norway, Turkey, the United Kingdom and the United States) or within 24 hours from the date of placing the goods on board (in Spain).

27. Most of the participants at the first meeting of the International Subcommittee felt that the date should not be considered an essential element of the bill of lading and an undated bill of lading should be considered valid. It was suggested, however, that a harmonized general provision that clarified the significance of the date mentioned in the bill of lading would be useful. It was also suggested that the International Subcommittee should examine the legal consequences of the issuance of a bill of lading bearing an inaccurate or incorrect date.

2. Signature

28. The signing of bills of lading is mandatory in some countries (as in Argentina, China, the Democratic People's Republic of Korea, Hungary, Italy, Japan, Lebanon, the Netherlands, Norway, Poland, Spain and Turkey), when it is not required (in Australia, Canada, Germany, Indonesia, New Zealand, the United Kingdom and the United States), bills of lading are signed at the request of the sender (in Germany) or are generally signed in practice (in Australia,

Canada, New Zealand, the United Kingdom and the United States) on account of banks' requirements for the issuance of letters of credit.

29. It has been suggested that the International Subcommittee should give special attention to the legal consequences of the lack of authority to sign a bill of lading on behalf of the apparent carrier and consider which are the acceptable means of signature of the transport document.

3. Statements in the transport documents in addition to the description of the goods

30. Some national systems require the bill of lading to state the name of the carrier (e.g. in China, Germany, Italy, Japan, Lebanon, Norway, Poland, Spain and Turkey) and the address of the carrier (in China, Germany, Lebanon and Norway) or the master (in Spain), or merely the carrier's domicile (in Italy) or "designation" (in Poland). Other systems have no such requirements (in Argentina, Australia, Canada, Hungary, Indonesia, the Netherlands, New Zealand, the United Kingdom and the United States), although in some of these systems the carrier's name is customarily indicated.

31. In this context, it has been suggested that the International Subcommittee should consider which are the relevant elements for the identification of the carrier and what are the implications for the purpose of the identification of the carrier of a valid incorporation of the terms of a charter party in the bill of lading.

C. Rights of the carrier

32. The main issues concerning the rights of the carrier that have been considered thus far by the International Subcommittee include the following: when freight is earned and when it is payable; what is the effect of contractual frustration on the obligation to pay freight; whether the carrier has a right to withhold delivery of the goods until freight is paid; whether the carrier may exercise a lien in the cargo; to what extent the shipper may rely upon a cesser clause to avoid liability; whether the carrier can claim for deadfreight, demurrage and other charges in the same manner as freight, or whether this should depend on the transport document.

1. Freight

33. The meaning of "freight prepaid" and "freight collect" are largely of uniform interpretation, that is, "prepaid" denies the carrier the right to claim freight from the consignee, while "collect" means that the carrier may claim freight from the consignee (in Argentina, Canada, China, the Democratic People's Republic of Korea, Indonesia, Italy, Japan, the Netherlands, New Zealand, Norway, Spain, Turkey and the United States). There is also significant consistency in approach to liability for payment of freight, with the receiver being liable to pay the freight (in Canada, Germany, Hungary, Japan, Lebanon, Poland, Norway and Turkey), or liability prima facie resting with the shipper (in Canada, Hungary, the Netherlands and the United States), but otherwise depending on the terms of the contract (in Argentina, Australia, China, Italy, Japan, New Zealand and Spain). Intermediate holders may (in Canada) or may not (in Japan) be liable for freight.

34. Freight is predominantly considered to be earned when the carriage has been performed, unless the contract states otherwise (in Argentina, Australia, Canada, China, Indonesia, Italy, Japan, the Netherlands, New Zealand, Norway, Turkey, the United Kingdom and the United States). Similarly, freight is typically payable when it is earned (upon arrival) unless the contract states otherwise (in Argentina, Australia, Canada, China, Indonesia, Italy, Japan, the Netherlands, New Zealand, Norway, Turkey, the United Kingdom and the United States).

35. The effect of frustration varies: the carrier may retain a right to freight (in Italy) or the carrier may retain a right to freight only if it has been earned (in the United Kingdom); in the proportion that has been earned compared with total freight (in Hungary, Japan, Norway, Spain and the United States); and in the freezing of the freight obligation, so that, if freight is paid before the frustrating event, the carrier retains it, and if not the carrier has no right to claim payment of freight (in Australia and New Zealand).

2. Deadfreight, demurrage and other changes

36. The shipper's liability for deadfreight, demurrage and other charges depends on the contract (in Argentina, Australia, Canada, Japan, New Zealand, Norway and the United Kingdom), although in Italy the shipper is liable for deadfreight, and in Turkey the carrier may refuse delivery for non-payment of deadfreight and other charges in the same manner as freight. Cesser clauses are generally valid (in Australia, Canada, China, Italy, the Netherlands, Norway, Spain, Sweden, Turkey, the United Kingdom and the United States), with Indonesia being an exception.

37. The consignee would appear, unless the contract specifies otherwise, to be liable for deadfreight, demurrage and other charges (in Australia, Canada, Japan, the Netherlands, New Zealand, Norway and the United Kingdom), although in Norway the consignee is only liable for loadport demurrage where its amount is expressly stated on the bill of lading.

3. Lien

38. The right of a carrier to withhold delivery of goods until freight has been paid is, with few exceptions (in Argentina), widely recognized (in Australia, Canada, China, Germany, Hungary, Indonesia, Italy, Japan, Lebanon, the Netherlands, New Zealand, Norway, Poland, Spain, Turkey, the United Kingdom and the United States). The carrier's right is possessory in nature and typically does not continue after delivery of the goods (in Australia, Canada, New Zealand, Norway, Poland, the United Kingdom and the United States), with some exceptions (in Argentina, Germany, Italy and Lebanon), provided that the right is actively pursued (in Argentina and Italy).

39. Although in Japan general liens may be exercised, this is not generally the case (in Argentina, Italy, Lebanon, the Netherlands, Spain and the United States) or not the case unless clearly stated in the contract of carriage (in Australia, Canada, New Zealand, Norway and the United Kingdom).

D. Obligations of shipper, intermediate holder and consignee

1. Shipper

40. The shipper is obliged to ship clearly identifiable cargo and to provide an accurate description of the goods in the transport document (in Argentina, Australia, Canada, Germany, Indonesia, Japan, the Netherlands, New Zealand, Norway, the United Kingdom and the United States). Where the shipper packages goods, the shipper is obliged to package them adequately according to their nature (in Germany); to ship dangerous goods only with the carrier's consent (in Japan and Germany the obligation is merely to notify the carrier of the dangerous goods); where applicable, to conform with any requirements as to marking and packaging of dangerous goods (in Canada); to deliver the goods to the carrier in the manner agreed in the transport document and to pay freight, unless otherwise agreed, provided such agreement is clearly evident on the face of the transport document (in Japan).

2. Intermediate holder

41. Responses to the questionnaire did not elucidate the obligations of intermediate holders.

3. Consignee

42. The consignee is obliged to receive (in Canada, China, Hungary, Indonesia, Italy, Japan, the Netherlands, Norway, Poland, Spain, the United Kingdom and the United States) and remove (in Canada) the goods, even if they are damaged (in Argentina, Canada, the Netherlands, Poland, Spain and the United Kingdom) as long as they remain recognizable (in Canada and Poland), "retain their commercial identity" (in Australia, New Zealand and the United Kingdom) or except for "a total constructive loss" (in the United States). Receipt should be conducted in a timely (in Australia, Canada, New Zealand, Poland, the United Kingdom and the United States) and cooperative manner (in Argentina, Australia, Italy, the Netherlands, New Zealand, Norway, Poland, Spain, the United Kingdom and the United States). In the event goods are damaged beyond recognition, the consignee is obliged to provide whatever cooperation is necessary for the carrier to survey the goods (in Spain).

43. The carrier is obliged to accept instructions regarding delivery of the goods if given by an appropriate holder (in Australia, Canada, China, Japan, New Zealand, Poland, the United Kingdom and the United States) and to make delivery of the goods at the destination to the consignee (in Argentina, Australia, Canada, Indonesia, Italy, the Netherlands, New Zealand, Poland, Turkey, the United Kingdom and the United States). Where reefer units are involved, the New Zealand association also requested an additional obligation to provide (upon request) information on temperature recordings for the period the goods were in the carrier's custody.

E. Delivery and receipt of the goods at destination

44. The questions considered by the International Subcommittee included the following: under what circumstances a consignee may refuse to accept delivery of the goods; what, in those circumstances, is the proper course of conduct for the carrier to follow; and what is the appropriate procedure for delivery when the goods arrive before the transport document, as often happens in practice.

45. A carrier must deliver the goods to the person entitled to take delivery. If the carrier delivers the goods without the consignee producing the bill of lading, the carrier is liable for any losses that ensue (in Australia, Germany, the Netherlands, New Zealand, Spain, Turkey, the United Kingdom and the United States). The letter of indemnity is a separate contract indemnifying the carrier for such liability. Delivery under a letter of indemnity has no effect on the right of the person entitled to delivery to claim against the carrier (in Australia, Canada, Hungary, Japan, the Netherlands, New Zealand, Norway, Spain, Turkey, the United Kingdom and the United States).

46. Most participants at the first meeting of the International Subcommittee were in favour of a duty to be expressly laid on the consignee to accept delivery. It was also indicated that in that event it should be the carrier's duty to notify the consignee that the goods were available for delivery. In addition, it was felt that, if the consignee failed to accept delivery or no consignee appeared at the place of destination or for any other reason the carrier was not able to deliver, the contractual counterpart of the carrier was in principle financially responsible and must also provide instructions as to the disposal of the goods. It was also suggested that bills of lading should be subject to limitation periods so that after the passing of a certain period of time there would no longer be any right to claim under a bill of lading.

47. The International Subcommittee also examined the question of the appropriate course of conduct for a carrier when a consignee did not attend at the discharge port to take delivery or refused to take delivery and under what circumstances the carrier might dispose of the goods.

48. A right of disposal exists in many national systems (in Argentina, Canada, Germany, Hungary, Indonesia, Italy, Japan, the Netherlands, New Zealand, Norway and the United States). The carrier may land the goods and process them through customs (in New Zealand), and warehouse them (in Argentina, Canada, China the Democratic People's Republic of Korea, Hungary, Indonesia, Italy, Japan,

the Netherlands, New Zealand, Norway, Turkey, the United Kingdom and the United States). Some national systems instead require the carrier to deposit the goods with the competent judicial authority (in Indonesia, Italy, Japan and Spain).

49. Notice is to be provided (in Germany, Hungary, Italy and Japan) immediately (in Hungary, Italy and Japan) to the consignee (in Japan) or to the consignor (in Hungary and Italy). The cost of storage attaches to the goods (in Argentina and the United States), to the shipper (in Canada, Hungary and Japan) or the consignee (in Canada, China, the Democratic People's Republic of Korea, the Netherlands, Norway, the United Kingdom and the United States), assuming the consignee has become a party to the contract of carriage (in the Netherlands) or demands delivery or makes a claim thereunder (in Australia, New Zealand and the United Kingdom).

50. The carrier may sell or auction the goods after a certain time. The period is 60 days in China, 15 days in Hungary, 14 days in Japan, a "reasonable period" in Norway and 20 days in Spain. Goods are sold under authority of the court (in China, Indonesia, Japan and the Netherlands). The goods may be sold if the consignee's failure to cooperate is ongoing (in New Zealand) or they may be auctioned at will (in Japan).

F. Rights of disposal and the right to give instructions to the carrier

51. One of the features of transportation contracts is that the contractual counterpart to the carrier has the right to dispose of the goods. This right includes in particular the right to ask the carrier to stop the goods in transit, to change the place at which delivery is to take place and to deliver the goods to a consignee other than that indicated by the consignee in the transport document. Apart from these rights, it is recognized that the holder of such rights is also able to renegotiate new terms with the carrier, whereas it is understood that the carrier in those circumstances is free to reject or accept such changes in the contract. While international conventions in the field of maritime law (the Hague Rules and the Hamburg Rules) have not covered that issue so far, a number of instruments concerning other modes of transportation have done so and thereby provide at least a basis for possible further unification.

52. It has been suggested that the International Subcommittee should further examine the question of when the right of disposal and the right to give instructions to the carrier is effectively transferred, taking into account the type of documentary evidence of the contract of carriage used by the parties (e.g. bill of lading, a sea waybill or an electronic equivalent to either of the latter documents) and situations where no transport document has been issued. It has been also suggested that the International Subcommittee should consider which proof of identity a person should be required to produce in order to exercise the right of disposal and the right to give instructions to the carrier.

IV. CONCLUSION

53. The work carried out thus far by CMI in cooperation with the secretariat has, as indicated above, focused on issues related to inspection and description of the goods in the transport document; content of the transport document; rights of the carrier; obligations of shipper, intermediate holder and consignee; delivery and receipt of the goods at destination; rights of disposal; and the right to give instructions to the carrier.

54. In the course of this work, it has been noted that, although bills of lading are still used, especially where a negotiable document is required, the actual carriage of goods by sea sometimes represents only a fragment of an international transport of goods. In the container trades, even a port-to-port bill of lading would involve receipt and delivery at some point not directly connected to the arrival of, or discharge from, the ocean vessel. Moreover, in most situations it is not possible to take delivery alongside the vessel. Furthermore, where different modes of transport are used, there are often gaps between mandatory regimes applying to the various transport modes involved. It has been proposed, therefore, that, in developing an internationally harmonized regime that covers the relationships between the parties to the contract of carriage for the full duration of the carrier's custody of the cargo, issues that arise in connection with activities that are integral to the carriage agreed to by the parties and that take place before loading and after discharge should also be considered, as well as issues that arise under shipments where more than one mode of transport is contemplated. Furthermore, while the emphasis of this work, as originally conceived, was on the review of areas of law governing the transportation of goods that had not previously been covered by international agreement, it has been increasingly felt that the present, broad-based project should be extended to include an updated liability regime that would be designed to complement the terms of the proposed harmonizing instrument.

55. It should be noted, in that connection, that similar expectations were voiced at the thirty-second session of the Commission, when interest was expressed in the announced study that went beyond the liability of carriers and that would examine the interdependence among various contracts involved in the international carriage of goods and the need to provide legal support to modern contract and transport practices. It was stated that increasing disharmony in the area of international carriage of goods was a source of concern and that, in order to provide a certain legal basis to modern contract and transport practices, it was necessary to look beyond the liability issues and, if need be, reconsider positions taken in the past. Furthermore, it was said that various regional initiatives in the area of transport law ought to be examined and borne in mind in any future work in that area of law.[9]

56. Following the identification of issues and the preliminary discussions that took place at the first meeting of the International Subcommittee, it was agreed that a CMI working group would prepare a paper in which such issues

[9] *Official Records of the General Assembly, Fifty-fourth Session, Supplement No. 17* (A/54/17), para. 417.

were set out and possible solutions put forward, in some cases on an alternative basis, for discussion by the International Subcommittee.

57. The Commission may wish to take note of the progress made since its thirty-second session, when it requested the secretariat to cooperate with CMI in gathering and analysing information on possible issues for future work on transport law. The Commission may wish to request that the secretariat continue its cooperation with CMI with a view to presenting, at the next session of the Commission, a report identifying issues in transport law in respect of which the Commission might undertake future work and presenting the possible solutions that would have been discussed in the course of the consultations between CMI and the secretariat, including, as appropriate, the conclusions that might be reached and suggestions that might be made at the colloquium on maritime law to be held in New York on 6 July 2000 in conjunction with the thirty-third session of the Commission.

VI. COORDINATION AND COOPERATION

A. International Standby Practices (ISP98): Report of the Secretary-General (A/CN.9/477) [Original: English]

1. At its thirty-second session in 1999, the Commission considered, on the basis of a report of the Secretary-General,[1] a request by the Director of the Institute of International Banking Law and Practice, Inc. to consider endorsing for worldwide use the new Rules on International Standby Practices (ISP98) (letter of request of 3 March 1999 is reproduced in annex I). However, owing to the fact that late publication of that report had prevented some delegations from carrying out consultations, the Commission felt obliged to postpone consideration of endorsement until the thirty-third session in 2000.

2. The official text of ISP98 in English, which has been endorsed by the International Chamber of Commerce (ICC) and issued as ICC publication No. 590, is reproduced in annex IV. Translations into Chinese, French, Russian or Spanish are reproduced in annex IV of the respective language versions of this note. Translations into Bulgarian, Hebrew, Korean and Turkish have been prepared and published. Translations into German, Italian, Japanese and Thai are currently being prepared.

3. As stated on the cover of that publication,

> "ISP98 fills an important gap in the market place. Though standby letters of credit have similarities with commercial letters of credit and other financial instruments, there are significant differences in scope and practice. Moreover, it is recognized that the ICC's Uniform Customs and Practice for Documentary Credits (UCP), which is internationally accepted for commercial letters of credit, is not appropriate for all forms of standbys. A new set of Rules was required for this workhorse of commerce and finance, which, in terms of value, exceeds commercial credits by a ratio of 5:1.
>
> "ISP98 reflects a distillation of practices from a wide range of standby users—bankers, merchants, rating agencies, corporate treasurers, credit managers, government officials and banking regulators. Like the UCP for commercial credits, ISP98 is destined to become the standard for the use of standbys in international transactions."

4. By way of general background, it may be noted that the subject of documentary credits and bank guarantees has been a topic in which the Commission has taken an interest since the time of its inception. The Commission endorsed the 1962 version of the Uniform Customs and Practice for Documentary Credits (UCP) at its second session in 1969,[2] the 1974 version at its eighth session in 1975,[3] the 1983 version at its seventeenth session in 1984[4] and the 1993 version at its twenty-seventh session in 1994.[5]

5. In view of the close link between ISP98 and the 1995 United Nations Convention on Independent Guarantees and Stand-by Letters of Credit, the Secretary of the Commission participated in the preparation of ISP98 so as to ensure consistency between these two supplementary texts. His prologue to the ICC publication is reproduced in annex III. Additional information on the reasons for the preparation of ISP98 and about its salient features may be deduced from the preface contained in annex II.

[1] A/CN.9/459. The present note largely reproduces A/CN.9/459, since at the thirty-second session of the Commission only the English and the French versions of ISP98 were available.

[2] Report of the United Nations Commission on International Trade Law on the work of its second session, *Official Records of the General Assembly, Twenty-fourth Session, Supplement No. 18* (A/7618), para. 95.

[3] Report of the United Nations Commission on International Trade Law on the work of its eighth session, *Official Records of the General Assembly, Thirtieth Session, Supplement No. 17* (A/10017), para. 41.

[4] Report of the United Nations Commission on International Trade Law on the work of its seventeenth session, *Official Records of the General Assembly, Thirty-ninth Session, Supplement No. 17* (A/39/17), para. 129.

[5] Report of the United Nations Commission on International Trade Law on the work of its twenty-seventh session, *Official Records of the General Assembly, Forty-ninth Session, Supplement No. 17* (A/49/17), para. 230.

ANNEX I

Letter of Professor James E. Byrne, Director of the Institute of International Banking Law and Practice, Inc

I am writing to request endorsement of the International Standby Practices (ISP98) by the United Nations Commission on International Trade Law.

These private rules of practice are intended to apply to standby letters of credit. The idea to prepare such rules was conceived during the deliberations of the UNCITRAL Working Group on

International Contract Practices which resulted in the United Nations Convention on Independent Guarantees and Standby Letters of Credit ("the Convention"). These rules were deliberately formulated to complement the Convention whose use is recommended in their Official Preface. The ISP98 drafting process itself was undertaken in regular consultation with the UNCITRAL secretariat and the Institute has used occasions to promote ISP98 as an opportunity also to promote adoption of the Convention.

ISP98 became effective 1 January 1999. It has been endorsed by the International Financial Services Association and the ICC Commission on Banking Technique and Practice, and issued as ICC publication No. 590. It is currently being used and promoted by major banks which issue standby letters of credit, and is expected to become the world standard within the next few years.

Because of the close links between ISP98 and the Convention, and due to UNCITRAL's past practice of endorsing similar rules of practice, such as UCP500 and Incoterms 1990, the Institute formally requests that the Commission consider endorsement of ISP98.

ANNEX II

Approved by the International Financial Services Association and the ICC Banking Commission

PREFACE

The International Standby Practices (ISP98) reflects generally accepted practice, custom, and usage of standby letters of credit. It provides separate rules for standby letters of credit in the same sense that the Uniform Customs and Practice for Documentary Credits (UCP) and the Uniform Rules for Demand Guarantees (URDG) do for commercial letters of credit and independent bank guarantees.

The formulation of standby letter of credit practices in separate rules evidences the maturity and importance of this financial product. The amounts outstanding of standbys greatly exceed the outstanding amounts of commercial letters of credit. While the standby is associated with the United States where it originated and where it is most widely used, it is truly an international product. Non-U.S. bank outstandings have exceeded those of U.S. banks in the United States alone. Moreover, the standby is used increasingly throughout the world.

Standbys are issued to support payment, when due or after default, of obligations based on money loaned or advanced, or upon the occurrence or non-occurrence of another contingency.

For convenience, standbys are commonly classified descriptively (and without operative significance in the application of these Rules) based on their function in the underlying transaction or other factors not necessarily related to the terms and conditions of the standby itself. For example:

A "Performance Standby" supports an obligation to perform other than to pay money, including for the purpose of covering losses arising from a default of the applicant in completion of the underlying transactions.

An "Advance Payment Standby" supports an obligation to account for an advance payment made by the beneficiary to the applicant.

A "Bid Bond/Tender Bond Standby" supports an obligation of the applicant to execute a contract if the applicant is awarded a bid.

A "Counter Standby" supports the issuance of a separate standby or other undertaking by the beneficiary of the counter standby.

A "Financial Standby" supports an obligation to pay money, including any instrument evidencing an obligation to repay borrowed money.

A "Direct Pay" Standby supports payment when due of an underlying payment obligation typically in connection with a financial standby without regard to a default.

An "Insurance Standby" supports an insurance or reinsurance obligation of the applicant.

A "Commercial Standby" supports the obligations of an applicant to pay for goods or services in the event of non-payment by other methods.

In the past, many standbys have been issued subject to the UCP even though it was intended for commercial letters of credit. The UCP reinforced the independence and documentary character of the standby. It also provided standards for examination and notice of dishonor and a basis to resist market pressures to embrace troublesome practices such as the issuance of standbys without expiration dates.

Despite these important contributions, it has long been apparent that the UCP was not fully applicable nor appropriate for standbys, as is recognized in UCP 500 Article 1 which provides that it applies "to the extent to which they may be applicable." Even the least complex standbys (those calling for presentation of a draft only) pose problems not addressed by the UCP. More complex standbys (those involving longer terms or automatic extensions, transfer on demand, requests that the beneficiary issue its own undertaking to another, and the like) require more specialized rules of practice. The ISP fills these needs.

The ISP differs from the UCP in style and approach because it must receive acceptance not only from bankers and merchants, but also from a broader range of those actively involved in standby law and practice—corporate treasurers and credit managers, rating agencies, government agencies and regulators, and indenture trustees as well as their counsel. Because standbys are often intended to be available in the event of disputes or applicant insolvency, their texts are subject to a degree of scrutiny not encountered in the commercial letter of credit context. As a result, the ISP is also written to provide guidance to lawyers and judges in the interpretation of standby practice.

Differences in substance result either from different practices, different problems, or the need for more precision. In addition, the ISP proposes basic definitions should the standby permit or require presentation of documents by electronic means. Since standbys infrequently require presentation of negotiable documents, standby practice is currently more conducive to electronic presentations, and the ISP provides definitions and rules encouraging such presentations. The development of S.W.I.F.T. message types for the ISP is anticipated.

The ISP, like the UCP for commercial letters of credit, simplifies, standardizes, and streamlines the drafting of standbys, and provides clear and widely accepted answers to common problems. There are basic similarities with the UCP because standby and commercial practices are fundamentally the same. Even where the rules overlap, however, the ISP is more precise, stating the intent implied in the UCP rule, in order to make the standby more dependable when a drawing or honor is questioned.

Like the UCP and the URDG, the ISP will apply to any independent undertaking issued subject to it. This approach avoids the impractical and often impossible task of identifying and distinguishing standbys from independent guarantees and, in many cases, commercial letters of credit. The choice of which set of rules to select is, therefore, left to the parties—as it should be. One may well choose to use the ISP for certain types of standbys, the UCP for others, and the URDG for still others. While the ISP is not intended to be used for dependent undertakings such as accessory guarantees and insurance contracts, it may be useful in some situations in indicating that a particular undertaking which might otherwise be treated as dependent under local law is intended to be independent.

For the ISP to apply to a standby, an undertaking should be made subject to these Rules by including language such as (but not limited to):

> This undertaking is issued subject to the International Standby Practices 1998.
> or
> Subject to ISP98.

Although the ISP can be varied by the text of a standby, it provides neutral rules acceptable in the majority of situations and a useful starting point for negotiations in other situations. It will save parties (including banks that issue, confirm, or are beneficiaries of standbys) considerable time and expense in negotiating and drafting standby terms.

The ISP is designed to be compatible with the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (which represents a useful and practical formulation of basic standby and independent guarantee law) and also with local law, whether statutory or judicial, and to embody standby letter of credit practice under that law. If these rules conflict with mandatory law on issues such as assignment of proceeds or transfer by operation of law, applicable law will, of course, control. Nonetheless, most of these issues are rarely addressed by local law and progressive commercial law will often look to the practice as recorded in the ISP for guidance in such situations, especially with respect to cross border undertakings. As a result, it is expected that the ISP will complement local law rather than conflict with it.

The ISP is intended to be used also in arbitration as well as judicial proceedings (such as the expert based letter of credit arbitration system developed by the International Center for Letter of Credit Arbitration (ICLOCA) Rules or general commercial ICC arbitration) or with alternative methods of dispute resolution. Such a choice should be made expressly and with appropriate detail. At a minimum, it can be made in connection with the clause relating to ISP98, for example. This undertaking is issued subject to ISP98, and all disputes arising out of it or related to it are subject to arbitration under ICLOCA Rules (1996).

Although translations of the ISP into other languages are envisioned and will be monitored for integrity, the English text is the official text of the ISP in the event of disputes.

The ISP is the product of the work of the ISP Working Group under the auspices of the Institute of International Banking Law & Practice, Inc. which interacted with hundreds of persons over a five year period, and has benefited from comments received from individuals, banks, and national and international associations. In particular, the participation of the International Financial Services Association (formerly the USCIB) and the Ad Hoc Working Group under the chairmanship of Gary Collyer (which led to its endorsement by the ICC Banking Commission) is gratefully recognized. In addition, the sponsorship and support of Citibank N.A., The Chase Manhattan Bank, ABN-AMRO, Baker & McKenzie, and the National Law Center for Inter-American Free Trade is acknowledged. Perhaps the greatest significance of the ISP is that its creation marks a new chapter in the collaboration between the international banking operations community and the legal community at an international level. In this respect, the active role played in this process by the secretariat of the United Nations Commission on International Trade Law has been invaluable.

The ISP is drafted as a set of rules intended for use in daily practice. It is not intended to provide introductory information on standbys and their uses. While it is recognized that specific rules would benefit from explanatory comments, such comments are not appended to the ISP because the resulting work would be too cumbersome for daily use. Instead, introductory materials and Official Comments are available in the *Official Commentary on the International Standby Practices (ISP98).* For further information on support materials and developments on the ISP and to pose queries, consult the ISP98 website: *www.ISP98.com.*

To address inevitable questions, to provide for official interpretation of the rules, and to assure their proper evolution, the Institute of International Banking Law & Practice, Inc. has created a Council on International Standby Practices which is representative of the several constituencies which have contributed to the ISP and has charged it with the task of maintaining the integrity of the ISP in cooperation with the Institute, the ICC Banking Commission, the IFSA, and various supporting organizations.

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ANNEX III

PROLOGUE

By Gerold Herrmann, Secretary

United Nations Commission on International Trade Law (UNCITRAL)

It was an extremely interesting and enriching experience for me to assist in drafting ISP98. This participation allowed me to witness (and now bear witness to) the very thorough and pragmatic drafting process in a superbly selected group, with representatives of all interested sectors actively involved in standby letter of credit practice such as: bankers, especially those responsible for letter of credit operations and global trade transactions, bank counsel, attorneys, academics, regulators, government officials, corporate treasurers, and likely influential beneficiaries. The treasure trove of experience and expertise and the diversity of interests and perspectives proved invaluable in determining—as was continuously done by examining concrete practical examples—whether on a given issue an operational rule would be desirable and useful and, if so, which solution would work best and reflect good practice.

Continued participation in the preparatory work has also convinced me—as, 1 am sure, it would have anyone else—of the special characteristics of standbys at the operational level of practical detail and usage. Their special features, in my view, not only justify but also necessitate special contractual rules designed for standbys. As the constant comparison with the UCP clearly revealed, quite a few UCP Articles are inappropriate for standbys and quite a few issues of paramount importance in standby practice are not addressed at all in the UCP. While a similar disparity in practice exists between the standby and the independent guarantee (the bank or demand guarantee European style), this seems particularly, if not exclusively, true for those types of actual use (e.g. financial standby, direct-pay standby) hitherto found only extremely rarely in guarantee practice. For this and other reasons, including firmness of the undertaking, 1 would not be surprised to see not only standbys but also some demand guarantees issued subject to ISP98.

For a professional unifier of law, participation in the preparatory work was particularly satisfying because of its interconnection with other harmonization and reform efforts. In addition to the concordance with revised Article 5 UCC (the letter-of-credit law of the homeland of the standby) and the similarly close contact (and personal overlap) with the 1993 UCP revision task force, 1 am referring in particular to UNCITRAL's work which culminated in the adoption in 1995 by the General Assembly of the "United Nations Convention on Independent Guarantees and Stand-by Letters of Credit." The idea of preparing special operational rules for standbys was born during the extensive debates comparing national laws as well as the two instruments to be married by that Convention. Since bride and groom were presented there in all facets and critically scrutinized by their future in-laws, UNCITRAL's *travaux preparatoires* make for highly informative reading (as will future abstracts of court decisions to be published in UNCITRAL's case collection system called CLOUT; homepage: *www.un.or.at/uncitral*). It was gratifying to see the group preparing ISP98 refer continuously to the UNCITRAL Convention in order to ensure complete consistency. I must admit to special gratification by overhearing one of the world's leading letter of credit expert's remark to his banking colleague: "The more I look at this UN Convention, the more I really like it."

The above coordination or cooperation in the universal harmonization and modernization efforts is welcome and in fact crucial because of the (often neglected or ignored) interdependence between the two very different levels of legal norms: the contractual level, where such sets of rules like ISP98, UCP 500, or URDG become effective by agreement of the individual parties, and the statutory level, where internationally elaborated law like the UN Convention or domestic law (e.g. Art. 5 UCC) recognize and give full effect to the exercise of that party autonomy and regulate certain issues that can effectively be settled only at that level (e.g. standards of fraud exception, injunctive relief and other court matters). Therefore, ISP98 and the Convention supplement each other in an ideal manner and together lay the necessary basis for a smooth functioning of standby practice worldwide.

ANNEX IV

Approved by the International Financial Services Association and the ICC Banking Commission

RULE 1: GENERAL PROVISIONS

Scope, application, definitions, and interpretation of these Rules

1.01 Scope and application

(a) These Rules are intended to be applied to standby letters of credit (including performance, financial, and direct pay standby letters of credit).

(b) A standby letter of credit or other similar undertaking, however named or described, whether for domestic or international use, may be made subject to these Rules by express reference to them.

(c) An undertaking subject to these Rules may expressly modify or exclude their application.

(d) An undertaking subject to these Rules is hereinafter referred to as a "standby".

1.02 Relationship to law and other Rules

(a) These Rules supplement the applicable law to the extent not prohibited by that law.

(b) These Rules supersede conflicting provisions in any other rules of practice to which a standby letter of credit is also made subject.

1.03 Interpretative principles

These Rules shall be interpreted as mercantile usage with regard for:

(a) integrity of standbys as reliable and efficient undertakings to pay;

(b) practice and terminology of banks and businesses in day-to-day transactions;

(c) consistency within the worldwide system of banking operations and commerce; and

(d) worldwide uniformity in their interpretation and application.

1.04 Effect of the Rules

Unless the context otherwise requires, or unless expressly modified or excluded, these Rules apply as terms and conditions incorporated into a standby, confirmation, advice, nomination, amendment, transfer, request for issuance, or other agreement of:

(i) the issuer;
(ii) the beneficiary to the extent it uses the standby;
(iii) any advisor;
(iv) any confirmer;
(v) any person nominated in the standby who acts or agrees to act; and
(vi) the applicant who authorizes issuance of the standby or otherwise agrees to the application of these Rules.

1.05 Exclusion of matters related to due issuance and fraudulent or abusive drawing

These Rules do not define or otherwise provide for:

(a) power or authority to issue a standby;

(b) formal requirements for execution of a standby (e.g. a signed writing); or

(c) defenses to honour based on fraud, abuse, or similar matters.

These matters are left to applicable law.

General principles

1.06 Nature of standbys

(a) A standby is an irrevocable, independent, documentary, and binding undertaking when issued and need not so state.

(b) Because a standby is irrevocable, an issuer's obligations under a standby cannot be amended or cancelled by the issuer except as provided in the standby or as consented to by the person against whom the amendment or cancellation is asserted.

(c) Because a standby is independent, the enforceability of an issuer's obligations under a standby does not depend on:

(i) the issuer's right or ability to obtain reimbursement from the applicant;
(ii) the beneficiary's right to obtain payment from the applicant;
(iii) a reference in the standby to any reimbursement agreement or underlying transaction; or
(iv) the issuer's knowledge of performance or breach of any reimbursement agreement or underlying transaction.

(d) Because a standby is documentary, an issuer's obligations depend on the presentation of documents and an examination of required documents on their face.

(e) Because a standby or amendment is binding when issued, it is enforceable against an issuer whether or not the applicant authorized its issuance, the issuer received a fee, or the beneficiary received or relied on the standby or the amendment.

1.07 Independence of the issuer-beneficiary relationship

An issuer's obligations toward the beneficiary are not affected by the issuer's rights and obligations toward the applicant under any applicable agreement, practice, or law.

1.08 Limits to responsibilities

An issuer is not responsible for:

(a) performance or breach of any underlying transaction;

(b) accuracy, genuineness, or effect of any document presented under the standby;

(c) action or omission of others even if the other person is chosen by the issuer or nominated person; or

(d) observance of law or practice other than that chosen in the standby or applicable at the place of issuance.

Terminology

1.09 Defined terms

In addition to the meanings given in standard banking practice and applicable law, the following terms have or include the meanings indicated below:

(a) Definitions

"Applicant" is a person who applies for issuance of a standby or for whose account it is issued, and includes (i) a person applying in its own name but for the account of another person or (ii) an issuer acting for its own account.

"Beneficiary" is a named person who is entitled to draw under a standby. See Rule 1.11*(c)*(ii).

"Business day" means a day on which the place of business at which the relevant act is to be performed is regularly open; and "Banking day" means a day on which the relevant bank is regularly open at the place at which the relevant act is to be performed.

"Confirmer" is a person who, upon an issuer's nomination to do so, adds to the issuer's undertaking its own undertaking to honour a standby. See Rule 1.11*(c)*(i).

"Demand" means, depending on the context, either a request to honour a standby or a document that makes such request.

"Document" means a draft, demand, document of title, investment security, invoice, certificate of default, or any other representation of fact, law, right, or opinion, that upon presentation (whether in a paper or electronic medium), is capable of being examined for compliance with the terms and conditions of a standby.

"Drawing" means, depending on the context, either a demand presented or a demand honoured.

"Expiration date" means the latest day for a complying presentation provided in a standby.

"Person" includes a natural person, partnership, corporation, limited liability company, government agency, bank, trustee, and any other legal or commercial association or entity.

"Presentation" means, depending on the context, either the act of delivering documents for examination under a standby or the documents so delivered.

"Presenter" is a person who makes a presentation as or on behalf of a beneficiary or nominated person.

"Signature" includes any symbol executed or adopted by a person with a present intent to authenticate a document.

(b) Cross references

"Amendment"—Rule 2.06

"Advice"—Rule 2.05

"Approximately" ("About" or "Circa")—Rule 3.08*(f)*

"Assignment of Proceeds"—Rule 6.06

"Automatic amendment"—Rule 2.06*(a)*

"Copy"—Rule 4.15*(d)*

"Cover instructions"—Rule 5.08

"Honour"—Rule 2.01

"Issuer"—Rule 2.01

"Multiple presentations"—Rule 3.08*(b)*

"Nominated person"—Rule 2.04

"Non-documentary conditions"—Rule 4.11

"Original"—Rule 4.15*(b)* and *(c)*

"Partial drawing"—Rule 3.08*(a)*

"Standby"—Rule 1.01*(d)*

"Transfer"—Rule 6.01

"Transferee beneficiary"—Rule 1.11*(c)*(ii)

"Transfer by operation of law"—Rule 6.11

(c) Electronic presentations

The following terms in a standby providing for or permitting electronic presentation shall have the following meanings unless the context otherwise requires:

"Electronic record" means:

(i) a record (information that is inscribed on a tangible medium or that is stored in an electronic or other medium and is retrievable in perceivable form);

(ii) communicated by electronic means to a system for receiving, storing, re-transmitting, or otherwise processing information (data, text, images, sounds, codes, computer programs, software, databases, and the like); and

(iii) capable of being authenticated and then examined for compliance with the terms and conditions of the standby.

"Authenticate" means to verify an electronic record by generally accepted procedure or methodology in commercial practice:

(i) the identity of a sender or source, and

(ii) the integrity of or errors in the transmission of information content.

The criteria for assessing the integrity of information in an electronic record is whether the information has remained complete and unaltered, apart from the addition of any endorsement and any change which arises in the normal course of communication, storage, and display.

"Electronic signature" means letters, characters, numbers, or other symbols in electronic form, attached to or logically associated with an electronic record that are executed or adopted by a party with present intent to authenticate an electronic record.

"Receipt" occurs when:

(i) an electronic record enters in a form capable of being processed by the information system designated in the standby, or

(ii) an issuer retrieves an electronic record sent to an information system other than that designated by the issuer.

1.10 Redundant or otherwise undesirable terms

(a) A standby should not or need not state that it is:

(i) unconditional or abstract (if it does, it signifies merely that payment under it is conditioned solely on presentation of specified documents);

(ii) absolute (if it does, it signifies merely that it is irrevocable);

(iii) primary (if it does, it signifies merely that it is the independent obligation of the issuer);

(iv) payable from the issuer's own funds (if it does, it signifies merely that payment under it does not depend on the availability of applicant funds and is made to satisfy the issuer's own independent obligation);

(v) clean or payable on demand (if it does, it signifies merely that it is payable upon presentation of a written demand or other documents specified in the standby).

(b) A standby should not use the term "and/or" (if it does it means either or both).

(c) The following terms have no single accepted meaning:

(i) and shall be disregarded:
"callable",
"divisible",
"fractionable",
"indivisible", and
"transmissible".

(ii) and shall be disregarded unless their context gives them meaning:
"assignable",
"evergreen",
"reinstate", and
"revolving".

1.11 Interpretation of these Rules

(a) These Rules are to be interpreted in the context of applicable standard practice.

(b) In these Rules, "standby letter of credit" refers to the type of independent undertaking for which these Rules were intended, whereas "standby" refers to an undertaking subjected to these Rules.

(c) Unless the context otherwise requires:

(i) "Issuer" includes a "confirmer" as if the confirmer were a separate issuer and its confirmation were a separate standby issued for the account of the issuer;

(ii) "Beneficiary" includes a person to whom the named beneficiary has effectively transferred drawing rights ("transferee beneficiary");

(iii) "Including" means "including but not limited to";

(iv) "A or B" means "A or B or both"; "either A or B" means "A or B, but not both"; and "A and B" means "both A and B";

(v) Words in the singular number include the plural, and in the plural include the singular; and

(vi) Words of the neuter gender include any gender.

(d) (i) Use of the phrase "unless a standby otherwise states" or the like in a rule emphasizes that the text of the standby controls over the rule;

(ii) Absence of such a phrase in other rules does not imply that other rules have priority over the text of the standby;

(iii) Addition of the term "expressly" or "clearly" to the phrase "unless a standby otherwise states" or the like emphasizes that the rule should be excluded or modified only by wording in the standby that is specific and unambiguous; and

(iv) While the effect of all of these Rules may be varied by the text of the standby, variations of the effect of some of these Rules may disqualify the standby as an independent undertaking under applicable law.

(e) The phrase "stated in the standby" or the like refers to the actual text of a standby (whether as issued or effectively amended) whereas the phrase "provided in the standby" or the like refers to both the text of the standby and these Rules as incorporated.

RULE 2: OBLIGATIONS

2.01 Undertaking to honour by issuer and any confirmer to beneficiary

(a) An issuer undertakes to the beneficiary to honour a presentation that appears on its face to comply with the terms and conditions of the standby in accordance with these Rules supplemented by standard standby practice.

(b) An issuer honours a complying presentation made to it by paying the amount demanded of it at sight, unless the standby provides for honour:

(i) by acceptance of a draft drawn by the beneficiary on the issuer, in which case the issuer honours by:
(a) timely accepting the draft; and
(b) thereafter paying the holder of the draft on presentation of the accepted draft on or after its maturity.

(ii) by deferred payment of a demand made by the beneficiary on the issuer, in which case the issuer honours by:
(a) timely incurring a deferred payment obligation; and
(b) thereafter paying at maturity.

(iii) by negotiation, in which case the issuer honours by paying the amount demanded at sight without recourse.

(c) An issuer acts in a timely manner if it pays at sight, accepts a draft, or undertakes a deferred payment obligation (or if it gives notice of dishonour) within the time permitted for examining the presentation and giving notice of dishonour.

(d) (i) A confirmer undertakes to honour a complying presentation made to it by paying the amount demanded of it at sight or, if the standby so states, by another method of honour consistent with the issuer's undertaking.

(ii) If the confirmation permits presentation to the issuer, then the confirmer undertakes also to honour upon the issuer's wrongful dishonour by performing as if the presentation had been made to the confirmer.

(iii) If the standby permits presentation to the confirmer, then the issuer undertakes also to honour upon the confirmer's wrongful dishonour by performing as if the presentation had been made to the issuer.

(e) An issuer honours by paying in immediately available funds in the currency designated in the standby unless the standby states it is payable by:

(i) payment of a monetary unit of account, in which case the undertaking is to pay in that unit of account; or

(ii) delivery of other items of value, in which case the undertaking is to deliver those items.

2.02 Obligation of different branches, agencies, or other offices

For the purposes of these Rules, an issuer's branch, agency, or other office acting or undertaking to act under a standby in a capacity other than as issuer is obligated in that capacity only and shall be treated as a different person.

2.03 Conditions to issuance

A standby is issued when it leaves an issuer's control unless it clearly specifies that it is not then "issued" or "enforceable". Statements that a standby is not "available", "operative", "effective", or the like do not affect its irrevocable and binding nature at the time it leaves the issuer's control.

2.04 Nomination

(a) A standby may nominate a person to advise, receive a presentation, effect a transfer, confirm, pay, negotiate, incur a deferred payment obligation, or accept a draft.

(b) Nomination does not obligate the nominated person to act except to the extent that the nominated person undertakes to act.

(c) A nominated person is not authorized to bind the person making the nomination.

2.05 Advice of standby or amendment

(a) Unless an advice states otherwise, it signifies that:

(i) the advisor has checked the apparent authenticity of the advised message in accordance with standard letter of credit practice; and

(ii) the advice accurately reflects what has been received.

(b) A person who is requested to advise a standby and decides not to do so should notify the requesting party.

2.06 When an amendment is authorized and binding

(a) If a standby expressly states that it is subject to "automatic amendment" by an increase or decrease in the amount available, an extension of the expiration date, or the like, the amendment is effective automatically without any further notification or consent beyond that expressly provided for in the standby. (Such an amendment may also be referred to as becoming effective "without amendment".)

(b) If there is no provision for automatic amendment, an amendment binds:

(i) the issuer when it leaves the issuer's control; and

(ii) the confirmer when it leaves the confirmer's control, unless the confirmer indicates that it does not confirm the amendment.

(c) If there is no provision for automatic amendment:

(i) the beneficiary must consent to the amendment for it to be binding;

(ii) the beneficiary's consent must be made by an express communication to the person advising the amendment unless the beneficiary presents documents which comply with the standby as amended and which would not comply with the standby prior to such amendment; and

(iii) an amendment does not require the applicant's consent to be binding on the issuer, the confirmer, or the beneficiary.

(d) Consent to only part of an amendment is a rejection of the entire amendment.

2.07 Routing of amendments

(a) An issuer using another person to advise a standby must advise all amendments to that person.

(b) An amendment or cancellation of a standby does not affect the issuer's obligation to a nominated person that has acted within the scope of its nomination before receipt of notice of the amendment or cancellation.

(c) Non-extension of an automatically extendable (renewable) standby does not affect an issuer's obligation to a nominated person who has acted within the scope of its nomination before receipt of a notice of non-extension.

RULE 3: PRESENTATION

3.01 Complying presentation under a standby

A standby should indicate the time, place and location within that place, person to whom, and medium in which presentation should be made. If so, presentation must be so made in order to comply. To the extent that a standby does not so indicate, presentation must be made in accordance with these Rules in order to be complying.

3.02 What constitutes a presentation?

The receipt of a document required by and presented under a standby constitutes a presentation requiring examination for compliance with the terms and conditions of the standby even if not all of the required documents have been presented.

3.03 Identification of standby

(a) A presentation must identify the standby under which the presentation is made.

(b) A presentation may identify the standby by stating the complete reference number of the standby and the name and location of the issuer or by attaching the original or a copy of the standby.

(c) If the issuer cannot determine from the face of a document received that it should be processed under a standby or cannot identify the standby to which it relates, presentation is deemed to have been made on the date of identification.

3.04 Where and to whom complying presentation made?

(a) To comply, a presentation must be made at the place and any location at that place indicated in the standby or provided in these Rules.

(b) If no place of presentation to the issuer is indicated in the standby, presentation to the issuer must be made at the place of business from which the standby was issued.

(c) If a standby is confirmed, but no place for presentation is indicated in the confirmation, presentation for the purpose of obligating the confirmer (and the issuer) must be made at the place of business of the confirmer from which the confirmation was issued or to the issuer.

(d) If no location at a place of presentation is indicated (such as department, floor, room, station, mail stop, post office box, or other location), presentation may be made to:

(i) the general postal address indicated in the standby;

(ii) any location at the place designated to receive deliveries of mail or documents; or

(iii) any person at the place of presentation actually or apparently authorized to receive it.

3.05 When timely presentation made?

(a) A presentation is timely if made at any time after issuance and before expiry on the expiration date.

(b) A presentation made after the close of business at the place of presentation is deemed to have been made on the next business day.

3.06 Complying medium of presentation

(a) To comply, a document must be presented in the medium indicated in the standby.

(b) Where no medium is indicated, to comply a document must be presented as a paper document, unless only a demand is required, in which case:

(i) a demand that is presented via S.W.I.F.T., tested telex, or other similar authenticated means by a beneficiary that is a S.W.I.F.T. participant or a bank complies; otherwise

(ii) a demand that is not presented as a paper document does not comply unless the issuer permits, in its sole discretion, the use of that medium.

(c) A document is not presented as a paper document if it is communicated by electronic means even if the issuer or nominated person receiving it generates a paper document from it.

(d) Where presentation in an electronic medium is indicated, to comply a document must be presented as an electronic record capable of being authenticated by the issuer or nominated person to whom it is presented.

3.07 Separateness of each presentation

(a) Making a non-complying presentation, withdrawing a presentation, or failing to make any one of a number of scheduled or permitted presentations does not waive or otherwise prejudice the right to make another timely presentation or a timely re-presentation whether or not the standby prohibits partial or multiple drawings or presentations.

(b) Wrongful dishonour of a complying presentation does not constitute dishonour of any other presentation under a standby or repudiation of the standby.

(c) Honour of a non-complying presentation, with or without notice of its non-compliance, does not waive requirements of a standby for other presentations.

3.08 Partial drawing and multiple presentations; amount of drawings

(a) A presentation may be made for less than the full amount available ("partial drawing").

(b) More than one presentation ("multiple presentations") may be made.

(c) The statement "partial drawings prohibited" or a similar expression means that a presentation must be for the full amount available.

(d) The statement "multiple drawings prohibited" or a similar expression means that only one presentation may be made and honoured but that it may be for less than the full amount available.

(e) If a demand exceeds the amount available under the standby, the drawing is discrepant. Any document other than the demand stating an amount in excess of the amount demanded is not discrepant for that reason.

(f) Use of "approximately", "about", "circa", or a similar word permits a tolerance not to exceed 10 per cent more or 10 per cent less of the amount to which such word refers.

3.09 Extend or pay

A beneficiary's request to extend the expiration date of the standby or, alternatively, to pay the amount available under it:

(a) is a presentation demanding payment under the standby, to be examined as such in accordance with these Rules; and

(b) implies that the beneficiary:

(i) consents to the amendment to extend the expiry date to the date requested;

(ii) requests the issuer to exercise its discretion to seek the approval of the applicant and to issue that amendment;

(iii) upon issuance of that amendment, retracts its demand for payment; and

(iv) consents to the maximum time available under these Rules for examination and notice of dishonour.

3.10 No notice of receipt of presentation

An issuer is not required to notify the applicant of receipt of a presentation under the standby.

3.11 Issuer waiver and applicant consent to waiver of presentation rules

In addition to other discretionary provisions in a standby or these Rules, an issuer may, in its sole discretion, without notice to or consent of the applicant and without effect on the applicant's obligations to the issuer, waive:

(a) the following Rules and any similar terms stated in the standby which are primarily for the issuer's benefit or operational convenience:

(i) treatment of documents received, at the request of the presenter, as having been presented at a later date (Rule 3.02);

(ii) identification of a presentation to the standby under which it is presented (Rule 3.03*(a)*);

(iii) where and to whom presentation is made (Rule 3.04*(b)*, *(c)*, and *(d)*), except the country of presentation stated in the standby; or

(iv) treatment of a presentation made after the close of business as if it were made on the next business day (Rule 3.05*(b)*).

(b) the following Rule but not similar terms stated in the standby:

(i) a required document dated after the date of its stated presentation (Rule 4.06); or

(ii) the requirement that a document issued by the beneficiary be in the language of the standby (Rule 4.04).

(c) the following Rule relating to the operational integrity of the standby only in so far as the bank is in fact dealing with the true beneficiary:

acceptance of a demand in an electronic medium (Rule 3.06*(b)*).

Waiver by the confirmer requires the consent of the issuer with respect to paragraphs *(b)* and *(c)* of this Rule.

3.12 Original standby lost, stolen, mutilated, or destroyed

(a) If an original standby is lost, stolen, mutilated, or destroyed, the issuer need not replace it or waive any requirement that the original be presented under the standby.

(b) If the issuer agrees to replace an original standby or to waive a requirement for its presentation, it may provide a replacement or copy to the beneficiary without affecting the applicant's obligations to the issuer to reimburse, but, if it does so, the issuer must mark the replacement or copy as such. The issuer may, in its sole discretion, require indemnities satisfactory to it from the beneficiary and assurances from nominated persons that no payment has been made.

Closure on expiry date

3.13 Expiration date on a non-business day

(a) If the last day for presentation stated in a standby (whether stated to be the expiration date or the date by which documents must be received) is not a business day of the issuer or nominated person where presentation is to be made, then presentation made there on the first following business day shall be deemed timely.

(b) A nominated person to whom such a presentation is made must so notify the issuer.

3.14 Closure on a business day and authorization of another reasonable place for presentation

(a) If on the last business day for presentation the place for presentation stated in a standby is for any reason closed and presentation is not timely made because of the closure, then the last day for presentation is automatically extended to the day occurring thirty calendar days after the place for presentation re-opens for business, unless the standby otherwise provides.

(b) Upon or in anticipation of closure of the place of presentation, an issuer may authorize another reasonable place for presentation in the standby or in a communication received by the beneficiary. If it does so, then

(i) presentation must be made at that reasonable place; and

(ii) if the communication is received fewer than thirty calendar days before the last day for presentation and for that reason presentation is not timely made, the last day for presentation is automatically extended to the day occurring thirty calendar days after the last day for presentation.

RULE 4: EXAMINATION

4.01 Examination for compliance

(a) Demands for honour of a standby must comply with the terms and conditions of the standby.

(b) Whether a presentation appears to comply is determined by examining the presentation on its face against the terms and conditions stated in the standby as interpreted and supplemented by these Rules which are to be read in the context of standard standby practice.

4.02 Non-examination of extraneous documents

Documents presented which are not required by the standby need not be examined and, in any event, shall be disregarded for purposes of determining compliance of the presentation. They may without responsibility be returned to the presenter or passed on with the other documents presented.

4.03 Examination for inconsistency

An issuer or nominated person is required to examine documents for inconsistency with each other only to the extent provided in the standby.

4.04 Language of documents

The language of all documents issued by the beneficiary is to be that of the standby.

4.05 Issuer of documents

Any required document must be issued by the beneficiary unless the standby indicates that the document is to be issued by a third person or the document is of a type that standard standby practice requires to be issued by a third person.

4.06 Date of documents

The issuance date of a required document may be earlier but not later than the date of its presentation.

4.07 Required signature on a document

(a) A required document need not be signed unless the standby indicates that the document must be signed or the document is of a type that standard standby practice requires be signed.

(b) A required signature may be made in any manner that corresponds to the medium in which the signed document is presented.

(c) Unless a standby specifies:

(i) the name of a person who must sign a document, any signature or authentication will be regarded as a complying signature.

(ii) the status of a person who must sign, no indication of status is necessary.

(d) If a standby specifies that a signature must be made by:

(i) a named natural person without requiring that the signer's status be identified, a signature complies that appears to be that of the named person;

(ii) a named legal person or government agency without identifying who is to sign on its behalf or its status, any signature complies that appears to have been made on behalf of the named legal person or government agency; or

(iii) a named natural person, legal person, or government agency requiring the status of the signer be indicated, a signature complies which appears to be that of the named natural person, legal person, or government agency and indicates its status.

4.08 Demand document implied

If a standby does not specify any required document, it will still be deemed to require a documentary demand for payment.

4.09 Identical wording and quotation marks

If a standby requires:

(a) a statement without specifying precise wording, then the wording in the document presented must appear to convey the same meaning as that required by the standby;

(b) specified wording by the use of quotation marks, blocked wording, or an attached exhibit or form, the typographical errors in spelling, punctuation, spacing, or the like that are apparent when read in context are not required to be duplicated and blank lines or spaces for data may be completed in any manner not inconsistent with the standby; or

(c) specified wording by the use of quotation marks, blocked wording, or an attached exhibit or form, and also provides that the specified wording be "exact" or "identical", then the wording in the documents presented must duplicate the specified wording, including typographical errors in spelling, punctuation, spacing and the like, as well as blank lines and spaces for data must be exactly reproduced.

4.10 Applicant approval

A standby should not specify that a required document be issued, signed, or counter-signed by the applicant. However, if the standby includes such a requirement, the issuer may not waive the requirement and is not responsible for the applicant's withholding of the document or signature.

4.11 Non-documentary terms or conditions

(a) A standby term or condition which is non-documentary must be disregarded whether or not it affects the issuer's obligation to treat a presentation as complying or to treat the standby as issued, amended, or terminated.

(b) Terms or conditions are non-documentary if the standby does not require presentation of a document in which they are to be evidenced and if their fulfillment cannot be determined by the issuer from the issuer's own records or within the issuer's normal operations.

(c) Determinations from the issuer's own records or within the issuer's normal operations include determinations of:

(i) when, where, and how documents are presented or otherwise delivered to the issuer;

(ii) when, where, and how communications affecting the standby are sent or received by the issuer, beneficiary, or any nominated person;

(iii) amounts transferred into or out of accounts with the issuer; and

(iv) amounts determinable from a published index (e.g. if a standby provides for determining amounts of interest accruing according to published interest rates).

(d) An issuer need not re-compute a beneficiary's computations under a formula stated or referenced in a standby except to the extent that the standby so provides.

4.12 Formality of statements in documents

(a) A required statement need not be accompanied by a solemnity, officialization, or any other formality.

(b) If a standby provides for the addition of a formality to a required statement by the person making it without specifying form or content, the statement complies if it indicates that it was declared, averred, warranted, attested, sworn under oath, affirmed, certified, or the like.

(c) If a standby provides for a statement to be witnessed by another person without specifying form or content, the witnessed statement complies if it appears to contain a signature of a person other than the beneficiary with an indication that the person is acting as a witness.

(d) If a standby provides for a statement to be counter-signed, legalized, visaed, or the like by a person other than the beneficiary acting in a governmental, judicial, corporate, or other representative capacity without specifying form or content, the statement complies if it contains the signature of a person other than the beneficiary and includes an indication of that person's representative capacity and the organization on whose behalf the person has acted.

4.13 No responsibility to identify beneficiary

Except to the extent that a standby requires presentation of an electronic record:

(a) a person honouring a presentation has No obligation to the applicant to ascertain the identity of any person making a presentation or any assignee of proceeds;

(b) payment to a named beneficiary, transferee, an acknowledged assignee, successor by operation of law, to an account or account number stated in the standby or in a cover instruction from the beneficiary or nominated person fulfils the obligation under the standby to effect payment.

4.14 Name of acquired or merged issuer or confirmer

If the issuer or confirmer is reorganized, merged, or changes its name, any required reference by name to the issuer or confirmer in the documents presented may be to it or its successor.

4.15 Original, copy, and multiple documents

(a) A presented document must be an original.

(b) Presentation of an electronic record, where an electronic presentation is permitted or required, is deemed to be an "original".

(c) (i) A presented document is deemed to be an original unless it appears on its face to have been reproduced from an original.

(ii) A document which appears to have been reproduced from an original is deemed to be an original if the signature or authentication appears to be original.

(d) A standby that requires presentation of a "copy" permits presentation of either an original or copy unless the standby states that only a copy be presented or otherwise addresses the disposition of all originals.

(e) If multiples of the same document are requested, only one must be an original unless:

(i) "duplicate originals" or "multiple originals" are requested in which case all must be originals; or

(ii) "two copies", "two-fold", or the like are requested in which case either originals or copies may be presented.

Standby document types

4.16 Demand for payment

(a) A demand for payment need not be separate from the beneficiary's statement or other required document.

(b) If a separate demand is required, it must contain:

(i) a demand for payment from the beneficiary directed to the issuer or nominated person;

(ii) a date indicating when the demand was issued;

(iii) the amount demanded; and

(iv) the beneficiary's signature.

(c) A demand may be in the form of a draft or other instruction, order, or request to pay. If a standby requires presentation of a "draft" or "bill of exchange", that draft or bill of exchange need not be in negotiable form unless the standby so states.

4.17 Statement of default or other drawing event

If a standby requires a statement, certificate, or other recital of a default or other drawing event and does not specify content, the document complies if it contains:

(a) a representation to the effect that payment is due because a drawing event described in the standby has occurred;

(b) a date indicating when it was issued; and

(c) the beneficiary's signature.

4.18 Negotiable documents

If a standby requires presentation of a document that is transferable by endorsement and delivery without stating whether, how, or to whom endorsement must be made, then the document may be presented without endorsement, or, if endorsed, the endorsement may be in blank and, in any event, the document may be issued or negotiated with or without recourse.

4.19 Legal or judicial documents

If a standby requires presentation of a government-issued document, a court order, an arbitration award, or the like, a document or a copy is deemed to comply if it appears to be:

(i) issued by a government agency, court, tribunal, or the like;

(ii) suitably titled or named;

(iii) signed;

(iv) dated; and

(v) originally certified or authenticated by an official of a government agency, court, tribunal, or the like.

4.20 Other documents

(a) If a standby requires a document other than one whose content is specified in these Rules without specifying the issuer, data content, or wording, a document complies if it appears to be appropriately titled or to serve the function of that type of document under standard standby practice.

(b) A document presented under a standby is to be examined in the context of standby practice under these Rules even if the document is of a type (such as a commercial invoice, transport documents, insurance documents or the like) for which the Uniform Customs and Practice for Documentary Credits contains detailed rules.

4.21 Request to issue separate undertaking

If a standby requests that the beneficiary of the standby issue its own separate undertaking to another (whether or not the standby recites the text of that undertaking):

(a) the beneficiary receives no rights other than its rights to draw under the standby even if the issuer pays a fee to the beneficiary for issuing the separate undertaking;

(b) neither the separate undertaking nor any documents presented under it need be presented to the issuer;

and

(c) if originals or copies of the separate undertaking or documents presented under it are received by the issuer although not required to be presented as a condition to honour of the standby:

(i) the issuer need not examine, and, in any event, shall disregard their compliance or consistency with the standby, with the beneficiary's demand under the standby, or with the beneficiary's separate undertaking; and

(ii) the issuer may without responsibility return them to the presenter or forward them to the applicant with the presentation.

RULE 5: NOTICE, PRECLUSION, AND DISPOSITION OF DOCUMENTS

5.01 Timely notice of dishonour

(a) Notice of dishonour must be given within a time after presentation of documents which is not unreasonable.

(i) Notice given within three business days is deemed to be not unreasonable and beyond seven business days is deemed to be unreasonable.

(ii) Whether the time within which notice is given is unreasonable does not depend upon an imminent deadline for presentation.

(iii) The time for calculating when notice of dishonour must be given begins on the business day following the business day of presentation.

(iv) Unless a standby otherwise expressly states a shortened time within which notice of dishonour must be given, the issuer has No obligation to accelerate its examination of a presentation.

(b) (i) The means by which a notice of dishonour is to be given is by telecommunication, if available, and, if not, by another available means which allows for prompt notice.

(ii) If notice of dishonour is received within the time permitted for giving the notice, then it is deemed to have been given by prompt means.

(c) Notice of dishonour must be given to the person from whom the documents were received (whether the beneficiary, nominated person, or person other than a delivery person) except as otherwise requested by the presenter.

5.02 Statement of grounds for dishonour

A notice of dishonour shall state all discrepancies upon which dishonour is based.

5.03 Failure to give timely notice of dishonour

(a) Failure to give notice of a discrepancy in a notice of dishonour within the time and by the means specified in the standby or these rules precludes assertion of that discrepancy in any document containing the discrepancy that is retained or re-presented, but does not preclude assertion of that discrepancy in any different presentation under the same or a separate standby.

(b) Failure to give notice of dishonour or acceptance or acknowledgement that a deferred payment undertaking has been incurred obligates the issuer to pay at maturity.

5.04 Notice of expiry

Failure to give notice that a presentation was made after the expiration date does not preclude dishonour for that reason.

5.05 Issuer request for applicant waiver without request by presenter

If the issuer decides that a presentation does not comply and if the presenter does not otherwise instruct, the issuer may, in its sole discretion, request the applicant to waive non-compliance or otherwise to authorize honour within the time available for giving notice of dishonour but without extending it. Obtaining the applicant's waiver does not obligate the issuer to waive non-compliance.

5.06 Issuer request for applicant waiver upon request of presenter

If, after receipt of notice of dishonour, a presenter requests that the presented documents be forwarded to the issuer or that the issuer seek the applicant's waiver:

(a) no person is obligated to forward the discrepant documents or seek the applicant's waiver;

(b) the presentation to the issuer remains subject to these Rules unless departure from them is expressly consented to by the presenter; and

(c) if the documents are forwarded or if a waiver is sought:

(i) the presenter is precluded from objecting to the discrepancies notified to it by the issuer;

(ii) the issuer is not relieved from examining the presentation under these Rules;

(iii) the issuer is not obligated to waive the discrepancy even if the applicant waives it; and

(iv) the issuer must hold the documents until it receives a response from the applicant or is requested by the presenter to return the documents, and if the issuer receives no such response or request within ten business days of its notice of dishonour, it may return the documents to the presenter.

5.07 Disposition of documents

Dishonoured documents must be returned, held, or disposed of as reasonably instructed by the presenter. Failure to give notice of the disposition of documents in the notice of dishonour does not preclude the issuer from asserting any defense otherwise available to it against honour.

5.08 Cover instructions/transmittal letter

(a) Instructions accompanying a presentation made under a standby may be relied on to the extent that they are not contrary to the terms or conditions of the standby, the demand, or these Rules.

(b) Representations made by a nominated person accompanying a presentation may be relied upon to the extent that they are not contrary to the terms or conditions of a standby or these Rules.

(c) Notwithstanding receipt of instructions, an issuer or nominated person may pay, give notice, return the documents, or otherwise deal directly with the presenter.

(d) A statement in the cover letter that the documents are discrepant does not relieve the issuer from examining the presentation for compliance.

5.09 Applicant notice of objection

(a) An applicant must timely object to an issuer's honour of a noncomplying presentation by giving timely notice by prompt means.

(b) An applicant acts timely if it objects to discrepancies by sending a notice to the issuer stating the discrepancies on which the objection is based within a time after the applicant's receipt of the documents which is not unreasonable.

(c) Failure to give a timely notice of objection by prompt means precludes assertion by the applicant against the issuer of any discrepancy or other matter apparent on the face of the documents received by the applicant, but does not preclude assertion of that objection to any different presentation under the same or a different standby.

RULE 6: TRANSFER, ASSIGNMENT, AND TRANSFER BY OPERATION OF LAW

Transfer of drawing rights

6.01 Request to transfer drawing rights

Where a beneficiary requests that an issuer or nominated person honour a drawing from another person as if that person were the beneficiary, these Rules on transfer of drawing rights ("transfer") apply.

6.02 When drawing rights are transferable

(a) A standby is not transferable unless it so states.

(b) A standby that states that it is transferable without further provision means that drawing rights:

(i) may be transferred in their entirety more than once;

(ii) may not be partially transferred; and

(iii) may not be transferred unless the issuer (including the confirmer) or another person specifically nominated in the standby agrees to and effects the transfer requested by the beneficiary.

6.03 Conditions to transfer

An issuer of a transferable standby or a nominated person need not effect a transfer unless:

(a) it is satisfied as to the existence and authenticity of the original standby; and

(b) the beneficiary submits or fulfils:

(i) a request in a form acceptable to the issuer or nominated person including the effective date of the transfer and the name and address of the transferee;

(ii) the original standby;

(iii) verification of the signature of the person signing for the beneficiary;

(iv) verification of the authority of the person signing for the beneficiary;

(v) payment of the transfer fee; and

(vi) any other reasonable requirements.

6.04 Effect of transfer on required documents

Where there has been a transfer of drawing rights in their entirety:

(a) a draft or demand must be signed by the transferee beneficiary; and

(b) the name of the transferee beneficiary may be used in place of the name of the transferor beneficiary in any other required document.

6.05 Reimbursement for payment based on a transfer

An issuer or nominated person paying under a transfer pursuant to Rule 6.03*(a)*, *(b)*(i), and *(b)*(ii) is entitled to reimbursement as if it had made payment to the beneficiary.

Acknowledgement of assignment of proceeds

6.06 Assignment of proceeds

Where an issuer or nominated person is asked to acknowledge a beneficiary's request to pay an assignee all or part of any proceeds of the beneficiary's drawing under the standby, these Rules on acknowledgement of an assignment of proceeds apply except where applicable law otherwise requires.

6.07 Request for acknowledgement

(a) Unless applicable law otherwise requires, an issuer or nominated person

(i) is not obligated to give effect to an assignment of proceeds which it has not acknowledged; and

(ii) is not obligated to acknowledge the assignment.

(b) If an assignment is acknowledged:

(i) the acknowledgement confers no rights with respect to the standby to the assignee who is only entitled to the proceeds assigned, if any, and whose rights may be affected by amendment or cancellation; and

(ii) the rights of the assignee are subject to:

(a) the existence of any net proceeds payable to the beneficiary by the person making the acknowledgement;

(b) rights of nominated persons and transferee beneficiaries;

(c) rights of other acknowledged assignees; and

(d) any other rights or interests that may have priority under applicable law.

6.08 Conditions to acknowledgement of assignment of proceeds

An issuer or nominated person may condition its acknowledgement on receipt of:

(a) the original standby for examination or notation;

(b) verification of the signature of the person signing for the beneficiary;

(c) verification of the authority of the person signing for the beneficiary;

(d) an irrevocable request signed by the beneficiary for acknowledgement of the assignment that includes statements, covenants, indemnities, and other provisions which may be contained in the issuer's or nominated person's required form requesting acknowledgement of assignment, such as:

(i) the identity of the affected drawings if the standby permits multiple drawings;

(ii) the full name, legal form, location, and mailing address of the beneficiary and the assignee;

(iii) details of any request affecting the method of payment or delivery of the standby proceeds;

(iv) limitation on partial assignments and prohibition of successive assignments;

(v) statements regarding the legality and relative priority of the assignment; or

(vi) right of recovery by the issuer or nominated person of any proceeds received by the assignee that are recoverable from the beneficiary;

(e) payment of a fee for the acknowledgement; and

(f) fulfilment of other reasonable requirements.

6.09 Conflicting claims to proceeds

If there are conflicting claims to proceeds, then payment to an acknowledged assignee may be suspended pending resolution of the conflict.

6.10 Reimbursement for payment based on an assignment

An issuer or nominated person paying under an acknowledged assignment pursuant to Rule 6.08*(a)* and *(b)* is entitled to reimbursement as if it had made payment to the beneficiary. If the beneficiary is a bank, the acknowledgement may be based solely upon an authenticated communication.

Transfer by operation of law

6.11 Transferee by operation of law

Where an heir, personal representative, liquidator, trustee, receiver, successor corporation, or similar person who claims to be designated by law to succeed to the interests of a beneficiary presents documents in its own name as if it were the authorized transferee of the beneficiary, these Rules on transfer by operation of law apply.

6.12 Additional document in event of drawing in successor's name

A claimed successor may be treated as if it were an authorized transferee of a beneficiary's drawing rights in their entirety if it presents an additional document or documents which appear to be issued by a public official or representative (including a judicial officer) and indicate:

(a) that the claimed successor is the survivor of a merger, consolidation, or similar action of a corporation, limited liability company, or other similar organization;

(b) that the claimed successor is authorized or appointed to act on behalf of the named beneficiary or its estate because of an insolvency proceeding;

(c) that the claimed successor is authorized or appointed to act on behalf of the named beneficiary because of death or incapacity; or

(d) that the name of the named beneficiary has been changed to that of the claimed successor.

6.13 Suspension of obligations upon presentation by successor

An issuer or nominated person which receives a presentation from a claimed successor which complies in all respects except for the name of the beneficiary:

(a) may request in a manner satisfactory as to form and substance:

(i) a legal opinion;

(ii) an additional document referred to in Rule 6.12 (Additional document in event of drawing in successor's name) from a public official;

(iii) statements, covenants, and indemnities regarding the status of the claimed successor as successor by operation of law;

(iv) payment of fees reasonably related to these determinations; and

(v) anything which may be required for a transfer under Rule 6.03 (Conditions to transfer) or an acknowledgement of assignment of proceeds under Rule 6.08 (Conditions to acknowledgement of assignment of proceeds);

but such documentation shall not constitute a required document for purposes of expiry of the standby.

(b) Until the issuer or nominated person receives the requested documentation, its obligation to honour or give notice of dishonour is suspended, but any deadline for presentation of required documents is not thereby extended.

6.14 Reimbursement for payment based on a transfer by operation of law

An issuer or nominated person paying under a transfer by operation of law pursuant to Rule 6.12 (Additional document in event of drawing in successor's name) is entitled to reimbursement as if it had made payment to the beneficiary.

RULE 7: CANCELLATION

7.01 When an irrevocable standby is cancelled or terminated

A beneficiary's rights under a standby may not be cancelled without its consent. Consent may be evidenced in writing or by an action such as return of the original standby in a manner which implies that the beneficiary consents to cancellation. A beneficiary's consent to cancellation is irrevocable when communicated to the issuer.

7.02 Issuer's discretion regarding a decision to cancel

Before acceding to a beneficiary's authorization to cancel and treating the standby as cancelled for all purposes, an issuer may require in a manner satisfactory as to form and substance:

(a) the original standby;

(b) verification of the signature of the person signing for the beneficiary;

(c) verification of the authorization of the person signing for the beneficiary;

(d) a legal opinion;

(e) an irrevocable authority signed by the beneficiary for cancellation that includes statements, covenants, indemnities, and similar provisions contained in a required form;

(f) satisfaction that the obligation of any confirmer has been cancelled;

(g) satisfaction that there has not been a transfer or payment by any nominated person; and

(h) any other reasonable measure.

RULE 8: REIMBURSEMENT OBLIGATIONS

8.01 Right to reimbursement

(a) Where payment is made against a complying presentation in accordance with these Rules, reimbursement must be made by:

(i) an applicant to an issuer requested to issue a standby; and

(ii) an issuer to a person nominated to honour or otherwise give value.

(b) An applicant must indemnify the issuer against all claims, obligations, and responsibilities (including attorney's fees) arising out of:

(i) the imposition of law or practice other than that chosen in the standby or applicable at the place of issuance;

(ii) the fraud, forgery, or illegal action of others; or

(iii) the issuer's performance of the obligations of a confirmer that wrongfully dishonours a confirmation.

(c) This Rule supplements any applicable agreement, course of dealing, practice, custom or usage providing for reimbursement or indemnification on lesser or other grounds.

8.02 Charges for fees and costs

(a) An applicant must pay the issuer's charges and reimburse the issuer for any charges that the issuer is obligated to pay to persons nominated with the applicant's consent to advise, confirm, honour, negotiate, transfer, or to issue a separate undertaking.

(b) An issuer is obligated to pay the charges of other persons:

(i) if they are payable in accordance with the terms of the standby; or

(ii) if they are the reasonable and customary fees and expenses of a person requested by the issuer to advise, honour, negotiate, transfer, or to issue a separate undertaking, and they are unrecovered and unrecoverable from the beneficiary or other presenter because no demand is made under the standby.

8.03 Refund of reimbursement

A nominated person that obtains reimbursement before the issuer timely dishonours the presentation must refund the reimbursement with interest if the issuer dishonours. The refund does not preclude the nominated person's wrongful dishonour claims.

8.04 Bank-to-bank reimbursement

Any instruction or authorization to obtain reimbursement from another bank is subject to the International Chamber of Commerce standard rules for bank-to-bank reimbursements.

RULE 9: TIMING

9.01 Duration of standby

A standby must:

(a) contain an expiry date; or

(b) permit the issuer to terminate the standby upon reasonable prior notice or payment.

9.02 Effect of expiration on nominated person

The rights of a nominated person that acts within the scope of its nomination are not affected by the subsequent expiry of the standby.

9.03 Calculation of time

(a) A period of time within which an action must be taken under these Rules begins to run on the first business day following the business day when the action could have been undertaken at the place where the action should have been undertaken.

(b) An extension period starts on the calendar day following the stated expiry date even if either day falls on a day when the issuer is closed.

9.04 Time of day of expiration

If no time of day is stated for expiration, it occurs at the close of business at the place of presentation.

9.05 Retention of standby

Retention of the original standby does not preserve any rights under the standby after the right to demand payment ceases.

RULE 10: SYNDICATION/PARTICIPATION

10.01 Syndication

If a standby with more than one issuer does not state to whom presentation may be made, presentation may be made to any issuer with binding effect on all issuers.

10.02 Participation

(a) Unless otherwise agreed between an applicant and an issuer, the issuer may sell participations in the issuer's rights against the applicant and any presenter and may disclose relevant applicant information in confidence to potential participants.

(b) An issuer's sale of participations does not affect the obligations of the issuer under the standby or create any rights or obligations between the beneficiary and any participant.

B. Uniform Rules for Contract Bonds (URCB): Report of the Secretary-General (A/CN.9/478) [Original: English]

1. At its thirty-second session in 1999, the Commission considered, on the basis of a report of the Secretary-General,[1] a request by the Secretary-General of the International Chamber of Commerce (ICC) to endorse the Uniform Rules for Contract Bonds (URCB) (letter of request of 27 April 1999 is reproduced in annex I). However, owing to the fact that late publication of that report had prevented some delegations from carrying out consultations, the Commission felt obliged to postpone consideration of endorsement until the thirty-third session in 2000.

2. The original text of the URCB in English, which has been issued by the ICC as publication no. 524, is reproduced in annex III. Translations into French and Spanish, prepared by the ICC, are reproduced in annex III to the respective language versions of this document. Translations into Bulgarian, Finnish, Icelandic, Korean, Italian, Japanese and Portuguese have also been prepared and published by the ICC.

3. With regard to the reasons that led to the preparation of the URCB, the Foreword to the URCB states:

> "Due to a need in the insurance industry for a uniform set of rules applicable internationally to contract bonds creating obligations of an accessory nature, the ICC Commission of Insurance undertook to elaborate the ICC Uniform Rules for Contract Bonds."

4. For further background information on the URCB, the introduction and general remarks from the ICC publication are set out in annex II.

[1] A/CN.9/459/Add.1. The present note largely reproduces A/CN.9/459/Add.1, since at the thirty-second session of the Commission only the English and the French versions of URCB were available.

ANNEX I

Letter of Ms. Maria Livanos Cattaui, Secretary-General of the International Chamber of Commerce

As you may be aware, several years ago ICC published a set of Uniform Rules for Contract Bonds (URCB). I write to ask that UNCITRAL give its formal recognition and endorsement to these rules. ICC is seeking similar endorsements from the World Bank, EU and Inter-American Development Bank.

The URCB deal with Conditional Guarantees, so-called accessory bonds, which relate directly to the underlying contract that is being guaranteed for performance purposes.

Today, the URCB exist in several languages (including English, Spanish, French, Italian, Icelandic, Japanese, Chinese and Korean). The Government of Japan, the International Federation of Consulting Engineers (FIDIC), the Institution of Electrical Engineers (IEE), the International Credit Insurance Association (ICIA), the Association of International French Contractors (SEFI), and the Panamerican Surety Association (PASA), among others, have adopted the URCB as a recommended standard for bonds issued by their members.

The use of URCB as a global framework for bonds will provide the desired uniformity in the domain of security forms, and thus help to promote international trade. We firmly believe that this new model form will be of benefit to the entire business community. Its recognition by public institutions will assist private contracting and facilitate the export and freedom of contracting worldwide.

ANNEX II

ICC UNIFORM RULES FOR CONTRACT BONDS

INTRODUCTION

These Uniform Rules have been drawn up by an ICC Working Party of members representing the Commission on Insurance and the building and engineering industry for worldwide application in relation to Contract Bonds, being those bonds creating obligations of an accessory nature, where the liability of the Surety or Guarantor arises and is conditional upon an established default on the part of a Contractor (defined in these Rules as the Principal) under the Contract which is the subject matter of the relevant Bond. The Rules set out below will therefore apply where the intention of the parties is that the obligations of the Guarantor will depend upon the duties or liabilities of the Principal under the relevant Contract.

Bonds governed by the ICC Rules set out below are intended to operate so as to confer upon the Beneficiary in each instance security for the performance or execution of contract obligations or payment of any sums which may fall due to the Beneficiary as a result of any breach of obligation or default by the Principal under the Contract. The Bond is intended to ensure that, subject to its financial limits, either the obligations set out in the Contract will be performed or executed, or that upon default, the Beneficiary will recover any sum properly due notwithstanding the insolvency of the Principal or the Principal's failure for any other reason to satisfy or discharge its liability. Accordingly, where a Bond governed by these Rules is in force, the Beneficiary will have the additional assurance of the Guarantor's accessory obligations to ensure that the judgement or award of any competent court or arbitral tribunal is satisfied.

The relationship of the parties under a Bond governed by these Rules number 524 differs from that arising under the ICC Uniform Rules for Demand Guarantees number 458 (the Demand Rules). Where the intention is that the Beneficiary is to obtain security for the obligations of the Principal arising pursuant to the Contract but that the Guarantor's liability shall only arise in case of an established default under that Contract, these Rules should be selected.

General

These Rules are intended to provide a clear and concise scheme to regulate the nature of obligations arising under Bonds and claims procedure. Because the nature of a Bond regulated by these Rules is that the obligations of the parties are related directly to and depend upon the obligations of the parties arising under the Contract, the Rules do not contain detailed provisions dealing with documentary requirements or the problem of unfair calling. In the event of a dispute arising as to the liability of a Guarantor, the Rules contemplate that such dispute will be determined by reference to the Contract. The Guarantor and the Principal are protected in that liability will arise only where default is established. The Beneficiary is protected by the assurance that any judgement or award will be discharged by the Guarantor if the Principal fails to do so.

The Uniform Rules for Contract Bonds number 524 set out below shall apply where expressly incorporated by the parties in accordance with their detailed provisions. These new Rules depend for their success upon their use by the international business community. The ICC recommends the use of these new Rules which will help to secure uniformity of practice in the operation and enforcement of Bonds.

ANNEX III

ICC UNIFORM RULES FOR CONTRACT BONDS

**Issued as ICC publication No. 524,
adopted by the ICC Executive Board on 23 April 1993,
come into effect on 1 January 1994**

CONTENTS

Article 1

Scope and application

(a) These Rules shall be known as the "Uniform Rules for Contract Bonds" and shall apply to any Bond which states that these Rules shall apply, or otherwise incorporates these Rules by reference and, for such purposes, it shall suffice that the Bond incorporates a reference to these Rules and the publication number.

(b) If there shall be any conflict in the construction or operation of the obligations of any parties under a Bond between the provisions of these Rules and such Bond, or mandatory provisions of the Applicable Law regulating the same, the provisions of the Bond or, as the case may be, the mandatory provisions of the Applicable Law shall prevail.

Article 2

Definitions

In these Rules, words or expressions shall bear the meanings set out below and be construed accordingly

Advance Payment Bond

A Bond given by the Guarantor in favour of the Beneficiary to secure the repayment of any sum or sums advanced by the Beneficiary to the Principal under or for the purposes of the Contract, where such sum or sums is or are advanced before the carrying out of works, the performance of services or the supply or provision of any goods pursuant to such Contract.

Beneficiary

The party in whose favour a Bond is issued or provided.

Bond

Any bond, guarantee or other instrument in writing issued or executed by the Guarantor in favour of the Beneficiary pursuant to which the Guarantor undertakes on Default, either:

(i) to pay or satisfy any claim or entitlement to payment of damages, compensation or other financial relief up to the Bond Amount; or

(ii) to pay or satisfy such claim or entitlement up to the Bond Amount or at the Guarantor's option to perform or execute the Contract or any Contractual Obligation.

In either case where the liability of the Guarantor shall be accessory to the liability of the Principal under the Contract or such Contractual Obligation and such expression shall without limitation include Advance Payment Bonds, Maintenance Bonds, Performance Bonds, Retention Bonds and Tender Bonds.

Bond Amount

The sum inserted in the Bond as the maximum aggregate liability of the Guarantor as amended, varied or reduced from time to time or, following the payment of any amount in satisfaction or partial satisfaction of a claim under any Bond, such lesser sum as shall be calculated by deducting from the sum inserted in the Bond the amount of any such payment.

Contract

Any written agreement between the Principal and the Beneficiary for the carrying out of works, the performance of services or the supply or provision of any goods.

Contractual Obligation

Any duty, obligation or requirement imposed by a clause, paragraph, section, term, condition, provision or stipulation contained in or forming part of a Contract or tender.

Default

Any breach, default or failure to perform any Contractual Obligation which shall give rise to a claim for performance, damages, compensation or other financial remedy by the Beneficiary and which is established pursuant to paragraph *j* of Article 7.

Expiry Date

Either *(a)* the date fixed or the date of the event on which the obligations of the Guarantor under the Bond are expressed to expire or *(b)* if no such date is stipulated, the date determined in accordance with Article 4.

Guarantor

Any Person who shall issue or execute a Bond on behalf of a Principal.

Maintenance Bond

A Bond to secure Contractual Obligations relating to the maintenance of works or goods following the physical completion or the provision thereof, pursuant to a Contract.

Performance Bond

A Bond to secure the performance of any Contract or Contractual Obligation.

Person

Any company, corporation, firm, association, body, individual or any legal entity whatsoever.

Principal

Any Person who (i) either *(a)* submits a tender for the purpose of entering into a Contract with the Beneficiary or *(b)* enters into a Contract with the Beneficiary and (ii) assumes primary liability for all Contractual Obligations thereunder.

Retention Bond

A Bond to secure the payment of any sum or sums paid or released to the Principal by the Beneficiary before the date for payment or release thereof contained in the Contract.

Tender Bond

A Bond in respect of a tender to secure the payment of any loss or damage suffered or incurred by the Beneficiary arising out of the failure by the Principal to enter into a Contract or provide a Performance Bond or other Bond pursuant to such tender.

Writing and Written

Shall include any authenticated tele-transmissions or tested electronic data interchange ("EDI") message equivalent thereto.

Article 3

Form of bond and liability of the guarantor to the beneficiary

(a) The Bond should stipulate:

(i) The Principal.
(ii) The Beneficiary.
(iii) The Guarantor.
(iv) The Contract.
(v) Where the Bond does not extend to the whole of the Contract, the precise Contractual Obligation or Obligations to which the Bond relates.
(vi) The Bond Amount.
(vii) Any provisions for the reduction of the Bond Amount.
(viii) The date when the Bond becomes effective (defined in these rules as the "Effective Date").
(ix) Whether the Guarantor shall be entitled at its option to perform or execute the Contract or any Contractual Obligation.
(x) The Expiry Date.
(xi) The names, addresses, telex and/or telefax numbers and contact references of the Beneficiary, the Guarantor and the Principal.
(xii) Whether sub-paragraph i of Article 7*(j)* is to apply and the name of the third party to be nominated thereunder for the purpose of Article 7 below (claims procedure).
(xiii) How disputes or differences between the Beneficiary, the Principal and the Guarantor in relation to the Bond are to be settled.

(b) The liability of the Guarantor to the Beneficiary under the Bond is accessory to the liability of the Principal to the Beneficiary under the Contract and shall arise upon Default. The Contract is deemed to be incorporated into and form part of the Bond. The liability of the Guarantor shall not exceed the Bond Amount.

(c) Save for any reduction of the Bond Amount under the terms of the Bond or the Contract and subject to Article 4, the liability of the Guarantor shall not be reduced or discharged by reason of any partial performance of the Contract or any Contractual Obligation.

(d) All defences, remedies, cross claims, counter-claims and other rights or entitlements to relief which the Principal may have against the Beneficiary under the Contract, or which may otherwise be available to the Principal in respect of the subject matter thereof, shall be available to the Guarantor in respect of any Default in addition to and without limiting any defence under or arising out of the Bond.

Article 4

Release and discharge of guarantor

(a) Subject to any contrary provision in the Bond and the provisions of paragraph *(b)* of this Article 4, the Expiry Date shall be six months from the latest date for the performance of the Contract or the relevant Contractual Obligations thereunder, as the case may be.

(b) Subject to any contrary provision of the Bond, the Expiry Date for the purposes of an Advance Payment Bond, a Maintenance Bond, a Retention Bond and a Tender Bond shall be as follows:

(i) In the case of an Advance Payment Bond, the date on which the Principal shall have carried out works, supplied goods or services or otherwise performed Contractual Obligations having a value as certified or otherwise determined pursuant to the Contract equal to or exceeding the Bond Amount.

(ii) In the case of a Maintenance Bond, six months after either the date stipulated by the Contract or, if no date has been specified for the termination of the Principal's maintenance obligations, the last day of the applicable warranty period or defects liability period under the Contract.

(iii) In the case of a Retention Bond, six months after the date stipulated by the Contract for the payment, repayment or release of any retention monies.

(iv) In the case of a Tender Bond, six months after the latest date set out in the tender documents or conditions for the submission of tenders.

(c) Where the Expiry Date falls on a day which is not a Business Day, the Expiry Date shall be the first following Business Day. For the purpose of these Rules "Business Day" shall mean any day on which the offices of the Guarantor shall ordinarily be open for business.

(d) A Bond shall terminate and, without prejudice to any term, provision, agreement or stipulation of the Bond, any other agreement or the Applicable Law providing for earlier release or discharge, the liability of the Guarantor shall be discharged absolutely and the Guarantor shall be released upon the Expiry Date whether or not the Bond shall be returned to the Guarantor, save in respect of any claim served in accordance with Article 7.

(e) Notwithstanding the provisions of paragraph *(d)* of this Article 4, the Bond may be cancelled at any time by the return of the Bond itself to the Guarantor or by the service upon and delivery or transmission to the Guarantor of a release in writing duly signed by an authorized representative of the Beneficiary, whether or not accompanied by the Bond and/or any amendment or amendments thereto.

(f) The Guarantor shall promptly inform the Principal of any payment made under or pursuant to the Bond and of the cancellation, release or discharge thereof or any reduction in the Bond Amount where the same shall not already have been communicated.

Article 5

Return of the bond

The Bond shall immediately after release or discharge under these Rules be returned to the Guarantor, and the retention or possession of the Bond following such release or discharge shall not of itself operate to confer any right or entitlement thereunder upon the Beneficiary.

Article 6

Amendments and variations to and of the contract and the bond and extensions of time

(a) The Bond shall, subject to the Bond Amount and the Expiry Date, apply to the Contract as amended or varied by the Principal and the Beneficiary from time to time.

(b) A Tender Bond shall be valid only in respect of the works and contract particulars set out or described in the tender documents at the Effective Date, and shall not apply beyond the Expiry Date or in any case where there shall be any substantial or material variation of or amendment to the original tender after the Effective Date, unless the Guarantor shall confirm, in the same manner as set out in paragraph c of this Article 6, that the Tender Bond so applies or the Expiry Date has been extended.

(c) Any amendment to a Bond, including without limitation the increase of the Bond Amount or the alteration of the Expiry Date, shall be in writing duly signed or executed by authorized representatives of each of the Beneficiary, the Principal and the Guarantor.

Article 7

Submission of claims and claims procedure

(a) A claim under a Bond shall be in writing and shall be served upon the Guarantor on or before the Expiry Date and by no later than the close of the Business Day at the Guarantor's principal place of business set out in the Bond, on the Expiry Date.

(b) A claim submitted by authenticated tele-transmission, EDI, telex or other means of telefax facsimile or electronic transmission shall be deemed to be received on the arrival of such transmission.

(c) A claim delivered to the Guarantor's principal place of business set out in the Bond shall, subject to proof of delivery, be deemed to be served on the date of such delivery.

(d) A claim served or transmitted by post shall, subject to satisfactory proof of delivery by the Beneficiary, be deemed to be served upon actual receipt thereof by the Guarantor.

(e) The Beneficiary shall, when giving notice of any claim by telefax or other tele-transmission or EDI, also send a copy of such claim by post.

(f) Any claim shall state brief details of the Contract to identify the same, state that there has been a breach or default and set out the circumstances of such breach or default and any request for payment, performance or execution.

(g) Upon receipt of a claim from the Beneficiary, the Guarantor shall send notice in writing to the Principal of such claim as soon as reasonably practicable and before either *(a)* making any payment in satisfaction or partial satisfaction of the same or *(b)* performing the Contract or any part thereof pursuant to a Contractual Obligation.

(h) The Beneficiary shall, upon written request by the Guarantor, supply to the Guarantor such further information as the Guarantor may reasonably request to enable it to consider the claim, and shall provide copies of any correspondence or other documents relating to the Contract or the performance of any Contractual Obligations and allow the Guarantor, its employees, agents or representatives to inspect any works, goods or services carried out or supplied by the Principal.

(i) A claim shall not be honoured unless

(i) A Default has occurred; and

(ii) The claim has been made and served in accordance with the provisions of paragraphs *(a)* to *(f)* of Article 7 on or before the Expiry Date.

(j) Notwithstanding any dispute or difference between the Principal and the Beneficiary in relation to the performance of the Contract or any Contractual Obligation, a Default shall be deemed to be established for the purposes of these Rules:

(i) upon issue of a certificate of Default by a third party (who may without limitation be an independent architect or engineer or a Pre-Arbitral referee of the ICC) if the Bond so provides and the service of such certificate or a certified copy thereof upon the Guarantor, or

(ii) if the Bond does not provide for the issue of a certificate by a third party, upon the issue of a certificate of Default by the Guarantor, or

(iii) by the final judgement, order or award of a court or tribunal of competent jurisdiction, and the issue of a certificate of Default under paragraph (i) or (ii) shall not restrict the rights of the parties to seek or require the determination of any dispute or difference arising under the Contract or the Bond or the review of any certificate of Default or payment made pursuant thereto by a court or tribunal of competent jurisdiction.

(k) A copy of any certificate of Default issued under *(j)* (i) or (ii) shall be given by the Guarantor to the Principal and the Beneficiary forthwith.

(l) The Guarantor shall consider any claim expeditiously and, if such claim is rejected, shall immediately give notice thereof to the Beneficiary by authenticated tele-transmission or other telefax, facsimile transmission, telex, cable or EDI, confirming the same by letter, setting out the grounds for such refusal including any defences or other matters raised under paragraph *(d)* of Article 3.

Article 8

Jurisdiction and settlement of disputes

(a) The Applicable Law shall be the law of the country selected by the parties to govern the operation of the Bond and, in the absence of any express choice of law, shall be the law governing the Contract and any dispute or difference arising under these Rules in relation to a Bond shall be determined in accordance with the Applicable Law.

(b) All disputes arising between the Beneficiary, the Principal and the Guarantor or any of them in relation to a Bond governed by these Rules shall, unless otherwise agreed, be finally settled under the Rules of Conciliation and Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules.

(c) If the Bond shall exclude the operation of the arbitration provisions of this Article 8, any dispute between the parties to the Bond shall be determined by the courts of the country nominated in the Bond, or, if there is no such nomination, the competent court of the Guarantor's principal place of business or, at the option of the Beneficiary, the competent court of the country in which the branch of the Guarantor which issued the Bond is situated.

C. ICC INCOTERMS 2000: Report of the Secretary-General (A/CN.9/479) [Original: English]

1. By letter of 28 February 2000 (reproduced in annex I), the Secretary-General of the International Chamber of Commerce (ICC) requested the Commission to consider endorsing Incoterms 2000 for worldwide use. This report gives the background to the previous actions of the Commission in respect of Incoterms 1953 and Incoterms 1990 and a short summary of the reasons for the preparation of the current revision. The original English text of Incoterms 2000 is reproduced in annex II to this document. Translations into Arabic, Chinese, French, Spanish or Russian are reproduced in annex II to the respective language versions of this document.

2. At the Commission's first session in 1968, in deciding on its programme of work, the Commission identified Incoterms 1953 as an international instrument of special importance with regard to the harmonization and unification of the law of the international sale of goods.[1] At its second session in 1969, with a view to encouraging the worldwide use of Incoterms 1953, the Commission, requested the Secretary-General to inform the ICC that Incoterms 1953 should be given the widest possible dissemination and to bring the views of the Commission to the attention of the United Nations regional economic commissions.[2]

3. Amendments to Incoterms were made and additional terms were added in 1976 and 1980. However, those changes in Incoterms were not officially brought to the attention of the Commission and the Commission took no action leading towards endorsing the revision. By the late 1980s ICC decided to completely revise Incoterms 1953 in order to adapt them to contemporary commercial practice. Incoterms 1990 was adopted by the ICC with a date of entry into force on 1 July 1990 and became available as ICC publication no. 460.

4. At its twenty-fifth session in 1992, the Commission considered a request of the Acting Secretary-General of the ICC to endorse Incoterms 1990 for worldwide use. At that session, the Commission was agreed that Incoterms 1990 succeeded in providing a modern set of international rules for the interpretation of the most commonly used trade terms in international trade and took the following decision endorsing Incoterms 1990:

"The United Nations Commission on International Trade Law,

"Expressing its appreciation to the International Chamber of Commerce for having transmitted to it the revised text of Incoterms, which was approved by the Commercial Practices Commission of the International Chamber of Commerce and entered into force on 1 July 1990, and for requesting the Commission to consider endorsing Incoterms 1990 for worldwide use,

"Congratulating the International Chamber of Commerce on having made a further contribution to the facilitation of international trade by revising Incoterms to take

[1] 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. 48.

[2] Report of the United Nations Commission on International Trade Law on the work of its second session, *Official Records of the General Assembly, Twenty-fourth Session, Supplement No. 16* (A/7218), para. 60.

account of changes in transportation techniques and to adapt the terms to the increasing use of electronic data interchange,

"Noting that Incoterms constitute a valuable contribution to the facilitation of international trade,

"Commends the use of Incoterms 1990 in international sales transactions."[3]

[3]Report of the United Nations Commission on International Trade Law on the work of its twenty-fifth session, *Official Records of the General Assembly, Forty-seventh Session,* (Supplement No.17 (A/47/17), paras. 160 and 161.

5. With regard to the reasons for the preparation of Incoterms 2000, the Foreword to Incoterms 2000 states:

"Since the creation of Incoterms by ICC in 1936, this undisputed worldwide contractual standard has been regularly updated to keep pace with the development of international trade. Incoterms 2000 take account of the recent spread of customs-free zones, the increased use of electronic communications in business transactions, and changes in transport practices. Incoterms 2000 offer a simpler and clearer presentation of the 13 definitions, all of which have been revised."

6. Incoterms 2000 has been adopted by the ICC with a date of entry into force on 1 January 2000. It is available from ICC as publication no. 560.

ANNEX I

Letter of Ms. Maria Livanos Cattaui, Secretar-General of the International Chamber of Commerce

I am writing to request endorsement of Incoterms 2000—the ICC official rules for the interpretation of trade terms—by the United Nations Commission on International Trade Law.

Incoterms 2000 have been released in September 1999 under ICC publication reference number 560 and have entered into force on 1 January 2000.

Incoterms 2000 are already used in countless commercial sales contracts. Incoterms are contractual terms, the incorporation of which in sales contracts usefully complements the provisions of the United Nations Convention on Contracts for the International Sale of Goods and reduces the risk of misunderstanding that could lead to legal complications.

This text of Incoterms 2000 is the result of a very comprehensive consultation process—in fact, Incoterms 2000 are based on the largest survey among business ever conducted in the history of Incoterms. We are therefore confident that the 13 new Incoterms reflect common commercial practice and respond to a business need for a global standard for the interpretation of trade terms.

Although the only authoritative text of Incoterms 2000 is the English one, ICC has decided to submit Incoterms 2000 to UNCITRAL in the six United Nations official languages. Please note, however, that in case of discrepancies between the various texts, only the English text should be considered as original, all other texts being translations.

ICC trusts that UNCITRAL will appreciate the effort made by ICC to facilitate international trade and to involve all interested parties in the dissemination of legal rules that have proven to reflect the needs of modern commercial transactions. As such, we hope that UNCITRAL will respond favourably to this formal request for endorsement of Incoterms 2000.

Therefore, as with the previous version of this authoritative legal standard, ICC would like to request formal endorsement of Incoterms by UNCITRAL.

ANNEX II

ICC INCOTERMS 2000

Entry into force 1 January 2000

INTRODUCTION

1. PURPOSE AND SCOPE OF INCOTERMS

The purpose of Incoterms is to provide a set of international rules for the interpretation of the most commonly used trade terms in foreign trade. Thus, the uncertainties of different interpretations of such terms in different countries can be avoided or at least reduced to a considerable degree.

Frequently, parties to a contract are unaware of the different trading practices in their respective countries. This can give rise to misunderstandings, disputes and litigation, with all the waste of time and money that this entails. In order to remedy these problems, the International Chamber of Commerce first published in 1936 a set of international rules for the interpretation of trade terms. These rules were known as "Incoterms 1936". Amendments and additions were later made in 1953, 1967, 1976, 1980, 1990 and presently in 2000 in order to bring the rules in line with current international trade practices.

It should be stressed that the scope of Incoterms is *limited* to matters relating to the rights and obligations of the parties to the contract of sale with respect to the *delivery* of *goods sold* (in the sense of "tangibles", not including "intangibles" such as computer software).

It appears that two particular misconceptions about Incoterms are very common. First, Incoterms are frequently misunderstood as applying to the contract of carriage rather than to the contract of sale. Second, they are sometimes wrongly assumed to provide for all the duties which parties may wish to include in a contract of sale.

As has always been underlined by ICC, Incoterms deal only with the relation between sellers and buyers under the contract of sale, and, moreover, only do so in some very distinct respects.

While it is essential for exporters and importers to consider the very practical relationship between the various contracts needed to perform an international sales transaction—where not only the contract of sale is required, but also contracts of carriage, insurance and financing—Incoterms relate to only one of these contracts, namely the contract of sale.

Nevertheless, the parties' agreement to use a particular Incoterm would necessarily have implications for the other contracts. To mention a few examples, a seller having agreed to a CFR—or CIF—contract cannot perform such a contract by any other mode of transport than carriage by sea, since under these terms he must present a bill of lading or other maritime document to the buyer which is simply not possible if other modes of transport are used. Furthermore, the document required under a documentary credit would necessarily depend upon the means of transport intended to be used.

Second, Incoterms deal with a number of identified obligations imposed on the parties—such as the seller's obligation to place the goods at the disposal of the buyer or hand them over for carriage or deliver them at destination—and with the distribution of risk between the parties in these cases.

Further, they deal with the obligations to clear the goods for export and import, the packing of the goods, the buyer's obligation to take delivery as well as the obligation to provide proof that the respective obligations have been duly fulfilled. Although Incoterms are extremely important for the implementation of the contract of sale, a great number of problems which may occur in such a contract are not dealt with at all, like transfer of ownership and other property rights, breaches of contract and the consequences following from such breaches as well as exemptions from liability in certain situations. It should be stressed that Incoterms are not intended to replace such contract terms that are needed for a complete contract of sale either by the incorporation of standard terms or by individually negotiated terms.

Generally, Incoterms do not deal with the consequences of breach of contract and any exemptions from liability owing to various impediments. These questions must be resolved by other stipulations in the contract of sale and the applicable law.

Incoterms have always been primarily intended for use where goods are sold for delivery across national boundaries: hence, international commercial terms. However, Incoterms are in practice at times also incorporated into contracts for the sale of goods within purely domestic markets. Where Incoterms are so used, the A2 and B2 clauses and any other stipulation of other articles dealing with export and import do, of course, become redundant.

2. WHY REVISIONS OF INCOTERMS?

The main reason for successive revisions of Incoterms has been the need to adapt them to contemporary commercial practice. Thus, in the 1980 revision the term Free Carrier (now FCA) was introduced in order to deal with the frequent case where the reception point in maritime trade was no longer the traditional FOB-point (passing of the ship's rail) but rather a point on land, prior to loading on board a vessel, where the goods were stowed into a container for subsequent transport by sea or by different means of transport in combination (so-called combined or multimodal transport).

Further, in the 1990 revision of Incoterms, the clauses dealing with the seller's obligation to provide proof of delivery permitted a replacement of paper documentation by EDI-messages provided the parties had agreed to communicate electronically. Needless to say, efforts are constantly made to improve upon the drafting and presentation of Incoterms in order to facilitate their practical implementation.

3. INCOTERMS 2000

During the process of revision, which has taken about two years, ICC has done its best to invite views and responses to successive drafts from a wide-ranging spectrum of world traders, represented as these various sectors are on the national committees through which ICC operates. Indeed, it has been gratifying to see that this revision process has attracted far more reaction from users around the world than any of the previous revisions of Incoterms. The result of this dialogue is Incoterms 2000, a version which when compared with Incoterms 1990 may appear to have effected few changes. It is clear, however, that Incoterms now enjoy worldwide recognition and ICC has therefore decided to consolidate upon that recognition and avoid change for its own sake. On the other hand, serious efforts have been made to ensure that the wording used in Incoterms 2000 clearly and accurately reflects trade practice. Moreover, substantive changes have been made in two areas:

— the customs clearance and payment of duty obligations under FAS and DEQ; and

— the loading and unloading obligations under FCA.

All changes, whether substantive or formal have been made on the basis of thorough research among users of Incoterms and particular regard has been given to queries received since 1990 by the Panel of Incoterms Experts, set up as an additional service to the users of Incoterms.

4. INCORPORATION OF INCOTERMS INTO THE CONTRACT OF SALE

In view of the changes made to Incoterms from time to time, it is important to ensure that where the parties intend to incorporate Incoterms into their contract of sale, an express reference is always made to the current version of Incoterms. This may easily be overlooked when, for example, a reference has been made to an earlier version in standard contract forms or in order forms used by merchants. A failure to refer to the current version may then result in disputes as to whether the parties intended to incorporate that version or an earlier version as a part of their contract. Merchants wishing to use Incoterms 2000 should therefore clearly specify that their contract is governed by "Incoterms 2000".

5. THE STRUCTURE OF INCOTERMS

In 1990, for ease of understanding, the terms were grouped in four basically different categories; namely starting with the term whereby the seller only makes the goods available to the buyer at the seller's own premises (the "E"-term Ex works); followed by the second group whereby the seller is called upon to deliver the goods to a carrier appointed by the buyer (the "F"-terms FCA, FAS and FOB); continuing with the "C"-terms where the seller has to contract for carriage, but without assuming the risk of loss of or damage to the goods or additional costs due to events occurring after shipment and dispatch (CFR, CIF, CPT and CIP); and, finally, the "D"-terms whereby the seller has to bear all costs and risks needed to bring the goods to the place of destination (DAF, DES, DEQ, DDU and DDP). The following chart sets out this classification of the trade terms.

INCOTERMS 2000

Group E *Departure*

EXW Ex Works (... named place)

Group F *Main carriage unpaid*

FCA Free Carrier (... named place)

FAS Free Alongside Ship (... named port of shipment)

FOB Free On Board (... named port of shipment)

Group C *Main carriage paid*

CFR Cost and Freight (... named port of destination)

CIF Cost, Insurance and Freight (… named port of destination)

CPT Carriage Paid To (... named place of destination)

CIP Carriage and Insurance Paid To (... named place of destination)

Group D *Arrival*

DAF Delivered At Frontier (... named place)

DES Delivered Ex Ship (... named port of destination)

DEQ Delivered Ex Quay (... named port of destination)

DDU Delivered Duty Unpaid (... named place of destination)

DDP Delivered Duty Paid (... named place of destination)

Further, under all terms, as in Incoterms 1990, the respective obligations of the parties have been grouped under 10 headings where each heading on the seller's side "mirrors" the position of the buyer with respect to the same subject matter.

6. TERMINOLOGY

While drafting Incoterms 2000, considerable efforts have been made to achieve as much consistency as possible and desirable with respect to the various expressions used throughout the thirteen terms. Thus, the use of different expressions intended to convey the same meaning has been avoided. Also, whenever possible, the same expressions as appear in the 1980 United Nations Convention on Contracts for the International Sale of Goods (CISG) have been used.

"shipper"

In some cases it has been necessary to use the same term to express two different meanings simply because there has been no suitable alternative. Traders will be familiar with this difficulty both in the context of contracts of sale and also of contracts of carriage. Thus, for example, the term "shipper" signifies both the person handing over the goods for carriage and the person who makes the contract with the carrier: however, these two "shippers" may be different persons, for example under a FOB contract where the seller would hand over the goods for carriage and the buyer would make the contract with the carrier.

"delivery"

It is particularly important to note that the term "delivery" is used in two different senses in Incoterms. First, it is used to determine when the seller has fulfilled his delivery obligation which is specified in the A4 clauses throughout Incoterms. Second, the term "delivery" is also used in the context of the buyer's obligation to take or accept delivery of the goods, an obligation which appears in the B4 clauses throughout Incoterms. Used in this second context, the word "delivery" means first that the buyer "accepts" the very nature of the "C"-terms, namely that the seller fulfils his obligations upon the shipment of the goods and, second that the buyer is obliged to receive the goods. This latter

obligation is important so as to avoid unnecessary charges for storage of the goods until they have been collected by the buyer. Thus, for example under CFR and CIF contracts, the buyer is bound to accept delivery of the goods and to receive them from the carrier and if the buyer fails to do so, he may become liable to pay damages to the seller who has made the contract of carriage with the carrier or, alternatively, the buyer might have to pay demurrage charges resting upon the goods in order to obtain the carrier's release of the goods to him. When it is said in this context that the buyer must "accept delivery", this does not mean that the buyer has accepted the goods as conforming with the contract of sale, but only that he has accepted that the seller has performed his obligation to hand the goods over for carriage in accordance with the contract of carriage which he has to make under the A3 *a)* clauses of the "C"-terms. So, if the buyer upon receipt of the goods at destination were to find that the goods did not conform to the stipulations in the contract of sale, he would be able to use any remedies which the contract of sale and the applicable law gave him against the seller, matters which, as has already been mentioned, lie entirely outside the scope of Incoterms.

Where appropriate, Incoterms 2000, have used the expression "placing the goods at the disposal of" the buyer when the goods are made available to the buyer at a particular place. This expression is intended to bear the same meaning as that of the phrase "handing over the goods" used in the 1980 United Nations Convention on Contracts for the International Sale of Goods.

"usual"

The word "usual" appears in several terms, for example in EXW with respect to the time of delivery (A4) and in the "C"-terms with respect to the documents which the seller is obliged to provide and the contract of carriage which the seller must procure (A8, A3). It can, of course, be difficult to tell precisely what the word "usual" means, however, in many cases, it is possible to identify what persons in the trade usually do and this practice will then be the guiding light. In this sense, the word "usual" is rather more helpful than the word "reasonable", which requires an assessment not against the world of practice but against the more difficult principle of good faith and fair dealing. In some circumstances it may well be necessary to decide what is "reasonable". However, for the reasons given, in Incoterms the word "usual" has been generally preferred to the word "reasonable".

"charges"

With respect to the obligation to clear the goods for import it is important to determine what is meant by "charges" which must be paid upon import of the goods. In Incoterms 1990 the expression "official charges payable upon exportation and importation of the goods" was used in DDP A6. In Incoterms 2000 DDP A6 the word "official" has been deleted, the reason being that this word gave rise to some uncertainty when determining whether the charge was "official" or not. No change of substantive meaning was intended through this deletion. The "charges" which must be paid only concern such charges as are a necessary consequence of the import as such and which thus have to be paid according to the applicable import regulations. Any additional charges levied by private parties in connection with the import are not to be included in these charges, such as charges for storage unrelated to the clearance obligation. However, the performance of that obligation may well result in some costs to customs brokers or freight forwarders if the party bearing the obligation does not do the work himself.

"ports", "places", "points" and "premises"

So far as concerns the place at which the goods are to be delivered, different expressions are used in Incoterms. In the terms intended to be used exclusively for carriage of goods by sea—such as FAS, FOB, CFR, CIF, DES and DEQ—the expressions "port of shipment" and "port of destination" have been used. In all other cases the word "place" has been used. In some cases, it has been deemed necessary also to indicate a "point" within the port or place as it may be important for the seller to know not only that the goods should be delivered in a particular area like a city but also where within that area the goods should be placed at the disposal of the buyer. Contracts of sale would frequently lack information in this respect and Incoterms therefore stipulate that if no specific point has been agreed within the named place, and if there are several points available, the seller may select the point which best suits his purpose (as an example see FCA A4). Where the delivery point is the seller's "place" the expression "the seller's premises" (FCA A4) has been used.

"ship" and "vessel"

In the terms intended to be used for carriage of goods by sea, the expressions "ship" and "vessel" are used as synonyms. Needless to say, the term "ship" would have to be used when it is an ingredient in the trade term itself such as in "free alongside ship" (FAS) and "delivery ex ship" (DES). Also, in view of the traditional use of the expression "passed the ship's rail" in FOB, the word "ship" has had to be used in that connection.

"checking" and "inspection"

In the A9 and B9 clauses of Incoterms the headings "checking—packaging and marking" and "inspection of the goods" respectively have been used. Although the words "checking" and "inspection" are synonyms, it has been deemed appropriate to use the former word with respect to the seller's delivery obligation under A4 and to reserve the latter for the particular case when a "pre-shipment inspection" is performed, since such inspection normally is only required when the buyer or the authorities of the export or import country want to ensure that the goods conform with contractual or official stipulations before they are shipped.

7. THE SELLER'S DELIVERY OBLIGATIONS

Incoterms focus on the seller's delivery obligation. The precise distribution of functions and costs in connection with the seller's delivery of the goods would normally not cause problems where the parties have a continuing commercial relationship. They would then establish a practice between themselves ("course of dealing") which they would follow in subsequent dealings in the same manner as they have done earlier. However, if a new commercial relationship is established or if a contract is made through the medium of brokers—as is common in the sale of commodities—one would have to apply the stipulations of the contract of sale and, whenever Incoterms 2000 have been incorporated into that contract, apply the division of functions, costs and risks following therefrom.

It would, of course, have been desirable if Incoterms could specify in as detailed a manner as possible the duties of the parties in connection with the delivery of the goods. Compared with Incoterms 1990, further efforts have been made in this respect in some specified instances (see for example FCA A4). But it has not been possible to avoid reference to customs of the trade in FAS and FOB A4 ("in the manner customary at the port"), the reason being that particularly in commodity trade the exact manner in which the goods are delivered for carriage in FAS and FOB contracts vary in the different sea ports.

8. PASSING OF RISKS AND COSTS RELATING TO THE GOODS

The risk of loss of or damage to the goods, as well as the obligation to bear the costs relating to the goods, passes from the

seller to the buyer when the seller has fulfilled his obligation to deliver the goods. Since the buyer should not be given the possibility to delay the passing of the risk and costs, all terms stipulate that the passing of risk and costs may occur even before delivery, if the buyer does not take delivery as agreed or fails to give such instructions (with respect to time for shipment and/or place for delivery) as the seller may require in order to fulfil his obligation to deliver the goods. It is a requirement for such premature passing of risk and costs that the goods have been identified as intended for the buyer or, as is stipulated in the terms, set aside for him (appropriation).

This requirement is particularly important under EXW, since under all other terms the goods would normally have been identified as intended for the buyer when measures have been taken for their shipment or dispatch ("F"- and "C"-terms) or their delivery at destination ("D"-terms). In exceptional cases, however, the goods may have been sent from the seller in bulk without identification of the quantity for each buyer and, if so, passing of risk and cost does not occur before the goods have been appropriated as aforesaid (cf. also article 69.3 of the 1980 United Nations Convention on Contracts for the International Sale of Goods).

9. THE TERMS

9.1 *The "E"-term is the term in which the seller's obligation is at its minimum:* the seller has to do no more than place the goods at the disposal of the buyer at the agreed place—usually at the seller's own premises. On the other hand, as a matter of practical reality, the seller would frequently assist the buyer in loading the goods on the latter's collecting vehicle. Although EXW would better reflect this if the seller's obligations were to be extended so as to include loading, it was thought desirable to retain the traditional principle of the seller's minimum obligation under EXW so that it could be used for cases where the seller does not wish to assume any obligation whatsoever with respect to the loading of the goods. If the buyer wants the seller to do more, this should be made clear in the contract of sale.

9.2 *The "F"-terms* require the seller to deliver the goods for carriage as instructed by the buyer. The point at which the parties intend delivery to occur in the FCA term has caused difficulty because of the wide variety of circumstances which may surround contracts covered by this term. Thus, the goods may be loaded on a collecting vehicle sent by the buyer to pick them up at the seller's premises; alternatively, the goods may need to be unloaded from a vehicle sent by the seller to deliver the goods at a terminal named by the buyer. Incoterms 2000 take account of these alternatives by stipulating that, when the place named in the contract as the place of delivery is the seller's premises, delivery is complete when the goods are loaded on the buyer's collecting vehicle and, in other cases, delivery is complete when the goods are placed at the disposal of the buyer not unloaded from the seller's vehicle. The variations mentioned for different modes of transport in FCA A4 of Incoterms 1990 are not repeated in Incoterms 2000.

The *delivery point* under FOB, which is the same under CFR and CIF, has been left unchanged in Incoterms 2000 in spite of a considerable debate. Although the notion under FOB to deliver the goods "across the ship's rail" nowadays may seem inappropriate in many cases, it is nevertheless understood by merchants and applied in a manner which takes account of the goods and the available loading facilities. It was felt that a change of the FOB-point would create unnecessary confusion, particularly with respect to sale of commodities carried by sea typically under charter parties.

Unfortunately, the word "FOB" is used by some merchants merely to indicate *any* point of delivery—such as "FOB factory", "FOB plant", "FOB Ex seller's works" or other inland points—thereby neglecting what the abbreviation means: **F**ree **O**n **B**oard. It remains the case that such use of "FOB" tends to create confusion and should be avoided.

There is an important change of FAS relating to the obligation to clear the goods for export, since it appears to be the most common practice to put this duty on the seller rather than on the buyer. In order to ensure that this change is duly noted it has been marked with capital letters in the preamble of FAS.

9.3 *The "C"-terms* require the seller to contract for carriage on usual terms at his own expense. Therefore, a point up to which he would have to pay transport costs must necessarily be indicated after the respective "C"-term. Under the CIF and CIP terms the seller also has to take out insurance and bear the insurance cost. Since the point for the division of costs is fixed at a point in the country of destination, the "C"-terms are frequently mistakenly believed to be arrival contracts, in which the seller would bear all risks and costs until the goods have actually arrived at the agreed point. However, it must be stressed that the "C"-terms are of the same nature as the "F"-terms in that the seller fulfils the contract in the country of shipment or dispatch. Thus, the contracts of sale under the "C"-terms, like the contracts under the "F"-terms, fall within the category of shipment contracts.

It is in the nature of shipment contracts that, while the seller is bound to pay the normal transport cost for the carriage of the goods by a usual route and in a customary manner to the agreed place, the risk of loss of or damage to the goods, as well as additional costs resulting from events occurring after the goods having been appropriately delivered for carriage, fall upon the buyer. Hence, the "C"-terms are distinguishable from all other terms in that they contain two "critical" points, one indicating the point to which the seller is bound to arrange and bear the costs of a contract of carriage and another one for the allocation of risk. For this reason, the greatest caution must be observed when adding obligations of the seller to the "C"-terms which seek to extend the seller's responsibility beyond the aforementioned "critical" point for the allocation of risk. It is of the very essence of the "C"-terms that the seller is relieved of any further risk and cost after he has duly fulfilled his contract by contracting for carriage and handing over the goods to the carrier and by providing for insurance under the CIF- and CIP-terms.

The essential nature of the "C"-terms as shipment contracts is also illustrated by the common use of documentary credits as the preferred mode of payment used in such terms. Where it is agreed by the parties to the sale contract that the seller will be paid by presenting the agreed shipping documents to a bank under a documentary credit, it would be quite contrary to the central purpose of the documentary credit for the seller to bear further risks and costs after the moment when payment had been made under documentary credits or otherwise upon shipment and dispatch of the goods. Of course, the seller would have to bear the cost of the contract of carriage irrespective of whether freight is pre-paid upon shipment or is payable at destination (freight collect); however, additional costs which may result from events occurring subsequent to shipment and dispatch are necessarily for the account of the buyer.

If the seller has to provide a contract of carriage which involves payment of duties, taxes and other charges, such costs will, of course, fall upon the seller to the extent that they are for his account under that contract. This is now explicitly set forth in the A6 clause of all "C"-terms.

If it is customary to procure several contracts of carriage involving transhipment of the goods at intermediate places in order to reach the agreed destination, the seller would have to pay all these costs, including any costs incurred when the goods are transhipped

from one means of conveyance to the other. If, however, the carrier exercised his rights under a transhipment—or similar clause—in order to avoid unexpected hindrances (such as ice, congestion, labour disturbances, government orders, war or warlike operations) then any additional cost resulting therefrom would be for the account of the buyer, since the seller's obligation is limited to procuring the usual contract of carriage.

It happens quite often that the parties to the contract of sale wish to clarify the extent to which the seller should procure a contract of carriage including the costs of discharge. Since such costs are normally covered by the freight when the goods are carried by regular shipping lines, the contract of sale will frequently stipulate that the goods are to be so carried or at least that they are to be carried under "liner terms". In other cases, the word "landed" is added after CFR or CIF. However, it is advisable not to use abbreviations added to the "C"-terms unless, in the relevant trade, the meaning of the abbreviations is clearly understood and accepted by the contracting parties or under any applicable law or custom of the trade.

In particular, the seller should not—and indeed could not, without changing the very nature of the "C"-terms—undertake any obligation with respect to the arrival of the goods at destination, since the risk of any delay during the carriage is borne by the buyer. Thus, any obligation with respect to time must necessarily refer to the place of shipment or dispatch, for example, "shipment (dispatch) not later than...". An agreement for example, "CFR Hamburg not later than..." is really a misnomer and thus open to different possible interpretations. The parties could be taken to have meant either that the goods must actually arrive at Hamburg at the specified date, in which case the contract is not a shipment contract but an arrival contract or, alternatively, that the seller must ship the goods at such a time that they would normally arrive at Hamburg before the specified date unless the carriage would have been delayed because of unforeseen events.

It happens in commodity trades that goods are bought while they are at sea and that, in such cases, the word "afloat" is added after the trade term. Since the risk of loss of or damage to the goods would then, under the CFR- and CIF-terms, have passed from the seller to the buyer, difficulties of interpretation might arise. One possibility would be to maintain the ordinary meaning of the CFR- and CIF-terms with respect to the allocation of risk between seller and buyer, namely that risk passes on shipment: this would mean that the buyer might have to assume the consequences of events having already occurred at the time when the contract of sale enters into force. The other possibility would be to let the passing of the risk coincide with the time when the contract of sale is concluded. The former possibility might well be practical, since it is usually impossible to ascertain the condition of the goods while they are being carried. For this reason the 1980 United Nations Convention on Contracts for the International Sale of Goods article 68 stipulates that "if the circumstances so indicate, the risk is assumed by the buyer from the time the goods were handed over to the carrier who issued the documents embodying the contract of carriage". There is, however, an exception to this rule when "the seller knew or ought to have known that the goods had been lost or damaged and did not disclose this to the buyer". Thus, the interpretation of a CFR- or CIF-term with the addition of the word "afloat" will depend upon the law applicable to the contract of sale. The parties are advised to ascertain the applicable law and any solution which might follow therefrom. In case of doubt, the parties are advised to clarify the matter in their contract.

In practice, the parties frequently continue to use the traditional expression C&F (or C and F, C+F). Nevertheless, in most cases it would appear that they regard these expressions as equivalent to CFR. In order to avoid difficulties of interpreting their contract the parties should use the correct Incoterm which is CFR, the only worldwide-accepted standard abbreviation for the term "Cost and Freight (... named port of destination)".

CFR and CIF in A8 of Incoterms 1990 obliged the seller to provide a copy of the charter party whenever his transport document (usually the bill of lading) contained a reference to the charter party, for example, by the frequent notation "all other terms and conditions as per charter party". Although, of course, a contracting party should always be able to ascertain all terms of his contract—preferably at the time of the conclusion of the contract—it appears that the practice to provide the charterparty as aforesaid has created problems particularly in connection with documentary credit transactions. The obligation of the seller under CFR and CIF to provide a copy of the charterparty together with other transport documents has been deleted in Incoterms 2000.

Although the A8 clauses of Incoterms seek to ensure that the seller provides the buyer with "proof of delivery", it should be stressed that the seller fulfils that requirement when he provides the "usual" proof. Under CPT and CIP it would be the "usual transport document" and under CFR and CIF a bill of lading or a sea waybill. The transport documents must be "clean", meaning that they must not contain clauses or notations expressly declaring a defective condition of the goods and/or the packaging. If such clauses or notations appear in the document, it is regarded as "unclean" and would then not be accepted by banks in documentary credit transactions. However, it should be noted that a transport document even without such clauses or notations would usually not provide the buyer with incontrovertible proof as against the carrier that the goods were shipped in conformity with the stipulations of the contract of sale. Usually, the carrier would, in standardized text on the front page of the transport document, refuse to accept responsibility for information with respect to the goods by indicating that the particulars inserted in the transport document constitute the shipper's declarations and therefore that the information is only "said to be" as inserted in the document. Under most applicable laws and principles, the carrier must at least use reasonable means of checking the correctness of the information and his failure to do so may make him liable to the consignee. However, in container trade, the carrier's means of checking the contents in the container would not exist unless he himself was responsible for stowing the container.

There are only two terms which deal with insurance, namely CIF and CIP. Under these terms the seller is obliged to procure insurance for the benefit of the buyer. In other cases it is for the parties themselves to decide whether and to what extent they want to cover themselves by insurance. Since the seller takes out insurance for the benefit of the buyer, he would not know the buyer's precise requirements. Under the Institute Cargo Clauses drafted by the Institute of London Underwriters, insurance is available in "minimum cover" under Clause C, "medium cover" under Clause B and "most extended cover" under Clause A. Since in the sale of commodities under the CIF term the buyer may wish to sell the goods in transit to a subsequent buyer who in turn may wish to resell the goods again, it is impossible to know the insurance cover suitable to such subsequent buyers and, therefore, the minimum cover under CIF has traditionally been chosen with the possibility for the buyer to require the seller to take out additional insurance. Minimum cover is however unsuitable for sale of manufactured goods where the risk of theft, pilferage or improper handling or custody of the goods would require more than the cover available under Clause C. Since CIP, as distinguished from CIF, would normally not be used for the sale of commodities, it would have been feasible to adopt the most extended cover under CIP rather than the minimum cover under CIF. But to vary the seller's insurance obligation under CIF and CIP would lead to confusion and both terms therefore limit the seller's insurance obligation to the minimum cover. It is particularly important for the CIP-buyer to

observe this: should additional cover be required, he should agree with the seller that the latter could take out additional insurance or, alternatively, arrange for extended insurance cover himself. There are also particular instances where the buyer may wish to obtain even more protection than is available under Institute Clause A, for example insurance against war, riots, civil commotion, strikes or other labour disturbances. If he wishes the seller to arrange such insurance he must instruct him accordingly in which case the seller would have to provide such insurance if procurable.

9.4 *The "D"-terms* are different in nature from the "C"-terms, since the seller according to the "D"-terms is responsible for the arrival of the goods at the agreed place or point of destination at the border or within *the country of import.* The seller must bear all risks and costs in bringing the goods thereto. Hence, the "D"-terms signify *arrival contracts,* while the "C"-terms evidence *departure* (shipment) *contracts.*

Under the "D"-terms except DDP the seller does not have to deliver the goods cleared for import *in the country of destination.*

Traditionally, the seller had the obligation to clear the goods for import under DEQ, since the goods had to be landed on the quay and thus were brought into the country of import. But owing to changes in customs clearance procedures in most countries, it is now more appropriate that the party domiciled in the country concerned undertakes the clearance and pays the duties and other charges. Thus, a change in DEQ has been made for the same reason as the change in FAS previously mentioned. As in FAS, in DEQ the change has been marked with capital letters in the preamble.

It appears that in many countries trade terms not included in Incoterms are used particularly in railway traffic ("franco border", "franco-frontière", "Frei Grenze"). However, under such terms it is normally not intended that the seller should assume the risk of loss of or damage to goods during the transport up to the border. It would be preferable in these circumstances to use CPT indicating the border. If, on the other hand, the parties intend that the seller should bear the risk during the transport, DAF indicating the border would be appropriate.

The DDU term was added in the 1990 version of Incoterms. The term fulfils an important function whenever the seller is prepared to deliver the goods in the country of destination without clearing the goods for import and paying the duty. In countries where import clearance may be difficult and time consuming, it may be risky for the seller to undertake an obligation to deliver the goods beyond the customs clearance point. Although, according to DDU B5 and B6, the buyer would have to bear the additional risks and costs which might follow from his failure to fulfil his obligations to clear the goods for import, the seller is advised not to use the DDU term in countries where difficulties might be expected in clearing the goods for import.

10. THE EXPRESSION "NO OBLIGATION"

As appears from the expressions "the seller must" and "the buyer must" Incoterms are only concerned with the obligations which the parties owe to each other. The words "No obligation" have therefore been inserted whenever one party does not owe an obligation to the other party. Thus, if for instance according to A3 of the respective term the seller has to arrange and pay for the contract of carriage we find the words "No obligation" under the heading "contract of carriage" in B3 *a)* setting forth the buyer's position. Again, where neither party owes the other an obligation, the words "No obligation" will appear with respect to *both* parties, for example, with respect to insurance.

In either case, it is important to point out that even though one party may be under "No obligation" towards the other to perform a certain task, this does not mean that it is not in his interest to perform that task. Thus, for example, just because a CFR buyer owes his seller no duty to make a contract of insurance under B4, it is clearly in his interest to make such a contract, the seller being under no such obligation to procure insurance cover under A4.

11. VARIANTS OF INCOTERMS

In practice, it frequently happens that the parties themselves by adding words to an Incoterm seek further precision than the term could offer. It should be underlined that Incoterms give no guidance whatsoever for such additions. Thus, if the parties cannot rely on a well-established custom of the trade for the interpretation of such additions they may encounter serious problems when no consistent understanding of the additions could be proven.

If for instance the common expressions "FOB stowed" or "EXW loaded" are used, it is impossible to establish a worldwide understanding to the effect that the seller's obligations are extended not only with respect to the cost of actually loading the goods in the ship or on the vehicle respectively but also include the risk of fortuitous loss of or damage to the goods in the process of stowage and loading. For these reasons, the parties are strongly advised to clarify whether they only mean that the function or the cost of the stowage and loading operations should fall upon the seller or whether he should also bear the risk until the stowage and loading has actually been completed. These are questions to which Incoterms do not provide an answer: consequently, if the contract too fails expressly to describe the parties' intentions, the parties may be put to much unnecessary trouble and cost.

Although Incoterms 2000 do not provide for many of these commonly used variants, the preambles to certain trade terms do alert the parties to the need for special contractual terms if the parties wish to go beyond the stipulations of Incoterms.

EXW the added obligation for the seller to load the goods on the buyer's collecting vehicle;

CIF/CIP the buyer's need for additional insurance;

DEQ the added obligation for the seller to pay for costs after discharge.

In some cases sellers and buyers refer to commercial practice in liner and charter party trade. In these circumstances, it is necessary to clearly distinguish between the obligations of the parties under the contract of carriage and their obligations to each other under the contract of sale. Unfortunately, there are no authoritative definitions of expressions such as "liner terms" and "terminal handling charges" (THC). Distribution of costs under such terms may differ in different places and change from time to time. The parties are recommended to clarify in the contract of sale how such costs should be distributed between themselves.

Expressions frequently used in charter parties, such as "FOB stowed", "FOB stowed and trimmed", are sometimes used in contracts of sale in order to clarify to what extent the seller under FOB has to perform stowage and trimming of the goods onboard the ship. Where such words are added, it is necessary to clarify in the contract of sale whether the added obligations only relate to costs or to both costs and risks.

As has been said, every effort has been made to ensure that Incoterms reflect the most common commercial practice. However in some cases—particularly where Incoterms 2000 differ from Incoterms 1990—the parties may wish the trade terms to operate differently. They are reminded of such options in the preamble of the terms signalled by the word "However".

12. CUSTOMS OF THE PORT OR OF A PARTICULAR TRADE

Since Incoterms provide a set of terms for use in different trades and regions it is impossible always to set forth the obligations of the parties with precision. To some extent it is therefore necessary to refer to the custom of the port or of the particular trade or to the practices which the parties themselves may have established in their previous dealings (cf. article 9 of the 1980 United Nations Convention on Contracts for the International Sale of Goods). It is of course desirable that sellers and buyers keep themselves duly informed of such customs when they negotiate their contract and that, whenever uncertainty arises, they clarify their legal position by appropriate clauses in their contract of sale. Such special provisions in the individual contract would supersede or vary anything that is set forth as a rule of interpretation in the various Incoterms.

13. THE BUYER'S OPTIONS AS TO THE PLACE OF SHIPMENT

In some situations, it may not be possible at the time when the contract of sale is entered into to decide precisely on the exact point or even the place where the goods should be delivered by the seller for carriage. For instance reference might have been made at this stage merely to a "range" or to a rather large place, for example, seaport, and it is then usually stipulated that the buyer has the right or duty to name later on the more precise point within the range or the place. If the buyer has a duty to name the precise point as aforesaid his failure to do so might result in liability to bear the risks and additional costs resulting from such failure (B5/B7 of all terms). In addition, the buyer's failure to use his right to indicate the point may give the seller the right to select the point which best suits his purpose (FCA A4).

14. CUSTOMS CLEARANCE

The term "customs clearance" has given rise to misunderstandings. Thus, whenever reference is made to an obligation of the seller or the buyer to undertake obligations in connection with passing the goods through customs of the country of export or import it is now made clear that this obligation does not only include the payment of duty and other charges but also the performance and payment of whatever administrative matters are connected with the passing of the goods through customs and the information to the authorities in this connection. Further, it has—although quite wrongfully—been considered in some quarters inappropriate to use terms dealing with the obligation to clear the goods through customs when, as in intra-European Union trade or other free trade areas, there is no longer any obligation to pay duty and no restrictions relating to import or export. In order to clarify the situation, the words *"where applicable"* have been added in the A2 and B2, A6 and B6 clauses of the relevant Incoterms *in order for them to be used without any ambiguity where no customs procedures are required.*

It is normally desirable that customs clearance is arranged by the party domiciled in the country where such clearance should take place or at least by somebody acting there on his behalf. Thus, the exporter should normally clear the goods for export, while the importer should clear the goods for import.

Incoterms 1990 departed from this under the trade terms EXW and FAS (export clearance duty on the buyer) and DEQ (import clearance duty on the seller) but in Incoterms 2000 FAS and DEQ place the duty of clearing the goods for export on the seller and to clear them for import on the buyer respectively, while EXW—representing the seller's minimum obligation—has been left unamended (export clearance duty on the buyer). Under DDP the seller specifically agrees to do what follows from the very name of the term—**D**elivered **D**uty **P**aid—namely to clear the goods for import and pay any duty as a consequence thereof.

15. PACKAGING

In most cases, the parties would know beforehand which packaging is required for the safe carriage of the goods to destination. However, since the seller's obligation to pack the goods may well vary according to the type and duration of the transport envisaged, it has been felt necessary to stipulate that the seller is obliged to pack the goods in such a manner as is required for the transport, but only to the extent that the circumstances relating to the transport are made known to him before the contract of sale is concluded (cf. articles 35.1. and 35.2*(b)* of the 1980 United Nations Convention on Contracts for the International Sale of Goods where the goods, including packaging, must be "fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract, except where the circumstances show that the buyer did not rely, or that it was unreasonable for him to rely, on the seller's skill and judgement").

16. INSPECTION OF GOODS

In many cases, the buyer may be well advised to arrange for inspection of the goods before or at the time they are handed over by the seller for carriage (so-called pre-shipment inspection or PSI). Unless the contract stipulates otherwise, the buyer would himself have to pay the cost for such inspection that is arranged in his own interest. However, if the inspection has been made in order to enable the seller to comply with any mandatory rules applicable to the export of the goods in his own country, the seller would have to pay for that inspection, unless the EXW term is used, in which case the costs of such inspection are for the account of the buyer.

17. MODE OF TRANSPORT AND THE APPROPRIATE INCOTERM 2000

Any mode of transport

Group E	**EXW**	Ex Works (... named place)
Group F	**FCA**	Free Carrier (... named place)
Group C	**CPT**	Carriage Paid To (... named place of destination)
	CIP	Carriage and Insurance Paid To (... named place of destination)
Group D	**DAF**	Delivered At Frontier (... named place)
	DDU	Delivered Duty Unpaid (... named place of destination)
	DDP	Delivered Duty Paid (... named place of destination)

Maritime and inland waterway transport only

Group F	**FAS**	Free Alongside Ship (... named port of shipment)
	FOB	Free On Board (... named port of shipment)
Group C	**CFR**	Cost and Freight (... named port of destination)
	CIF	Cost, Insurance and Freight (... named port of destination)
Group D	**DES**	Delivered Ex Ship (... named port of destination)
	DEQ	Delivered Ex Quay (... named port of destination)

18. THE RECOMMENDED USE

In some cases the preamble recommends the use or non-use of a particular term. This is particularly important with respect to the choice between FCA and FOB. Regrettably, merchants continue to use FOB when it is totally out of place thereby causing the seller to incur risks subsequent to the handing over of the goods to the carrier named by the buyer. FOB is only appropriate to use where the goods are intended to be delivered "across the ship's rail" or, in any event, *to the ship* and not where the goods are handed over *to the carrier* for subsequent entry into the ship, for example stowed in containers or loaded on lorries or wagons in so-called roll on—roll off traffic. Thus, a *strong warning* has been made in the preamble of FOB that the term *should not be used* when the parties do not intend delivery across the ship's rail.

It happens that the parties by mistake use terms intended for carriage of goods by sea also when another mode of transport is contemplated. This may put the seller in the unfortunate position that he cannot fulfil his obligation to tender the proper document to the buyer (for example a bill of lading, sea waybill or the electronic equivalent). The chart printed at paragraph 17 above makes clear which trade term in Incoterms 2000 it is appropriate to use for which mode of transport. Also, it is indicated in the preamble of each term whether it can be used for all modes of transport or only for carriage of goods by sea.

19. THE BILL OF LADING AND ELECTRONIC COMMERCE

Traditionally, the on board bill of lading has been the only acceptable document to be presented by the seller under the CFR and CIF terms. The bill of lading fulfils three important functions, namely:

— proof of delivery of the goods on board the vessel;
— evidence of the contract of carriage; and
— a means of transferring rights to the goods in transit to another party by the transfer of the paper document to him.

Transport documents other than the bill of lading would fulfil the two first-mentioned functions, but would not control the delivery of the goods at destination or enable a buyer to sell the goods in transit by surrendering the paper document to his buyer. Instead, other transport documents would name the party entitled to receive the goods at destination. The fact that the possession of the bill of lading is required in order to obtain the goods from the carrier at destination makes it particularly difficult to replace by electronic means of communication.

Further, it is customary to issue bills of lading in several originals but it is, of course, of vital importance for a buyer or a bank acting upon his instructions in paying the seller to ensure that all originals are surrendered by the seller (so-called "full set"). This is also a requirement under the ICC Rules for Documentary Credits (the so-called ICC Uniform Customs and Practice, "UCP"; current version at date of publication of Incoterms 2000: ICC publication 500).

The transport document must evidence not only delivery of the goods to the carrier but also that the goods, as far as could be ascertained by the carrier, were received in good order and condition. Any notation on the transport document which would indicate that the goods had not been in such condition would make the document "unclean" and would thus make it unacceptable under the UCP.

In spite of the particular legal nature of the bill of lading it is expected that it will be replaced by electronic means in the near future. The 1990 version of Incoterms had already taken this expected development into proper account. According to the A8 clauses, paper documents may be replaced by electronic messages provided the parties have agreed to communicate electronically. Such messages could be transmitted directly to the party concerned or through a third party providing added-value services. One such service that can be usefully provided by a third party is registration of successive holders of a bill of lading. Systems providing such services, such as the so-called BOLERO service, may require further support by appropriate legal norms and principles as evidenced by the CMI 1990 Rules for Electronic Bills of Lading and articles 16 and 17 of the 1996 UNCITRAL Model Law on Electronic Commerce.

20. NON-NEGOTIABLE TRANSPORT DOCUMENTS INSTEAD OF BILLS OF LADING

In recent years, a considerable simplification of documentary practices has been achieved. Bills of lading are frequently replaced by non-negotiable documents similar to those which are used for other modes of transport than carriage by sea. These documents are called "sea waybills", "liner waybills", "freight receipts", or variants of such expressions. Non-negotiable documents are quite satisfactory to use except where the buyer wishes to sell the goods in transit by surrendering a paper document to the new buyer. In order to make this possible, the obligation of the seller to provide a bill of lading under CFR and CIF must necessarily be retained. However, when the contracting parties know that the buyer does not contemplate selling the goods in transit, they may specifically agree to relieve the seller from the obligation to provide a bill of lading, or, alternatively, they may use CPT and CIP where there is no requirement to provide a bill of lading.

21. THE RIGHT TO GIVE INSTRUCTIONS TO THE CARRIER

A buyer paying for the goods under a "C"-term should ensure that the seller upon payment is prevented from disposing of the goods by giving new instructions to the carrier. Some transport documents used for particular modes of transport (air, road or rail) offer the contracting parties a possibility to bar the seller from giving such new instructions to the carrier by providing the buyer with a particular original or duplicate of the waybill. However, the documents used instead of bills of lading for maritime carriage do not normally contain such a barring function. The Comité Maritime International has remedied this shortcoming of the above-mentioned documents by introducing the 1990 "Uniform Rules for Sea Waybills" enabling the parties to insert a "no-disposal" clause whereby the seller surrenders the right to dispose of the goods by instructions to the carrier to deliver the goods to somebody else or at another place than stipulated in the waybill.

22. ICC ARBITRATION

Contracting parties who wish to have the possibility of resorting to ICC Arbitration in the event of a dispute with their contracting partner should specifically and clearly agree upon ICC Arbitration in their contract or, in the event that no single contractual document exists, in the exchange of correspondence which constitutes the agreement between them. The fact of incorporating one or more Incoterms in a contract or the related correspondence does NOT by itself constitute an agreement to have resort to ICC Arbitration.

The following standard arbitration clause is recommended by ICC:

"All disputes arising out of or in connection with the present contract shall be finally settled under the Rules of Arbitration of the International Chamber of Commerce by one or more arbitrators appointed in accordance with the said Rules."

EXW

Ex works (... named place)

"Ex works" means that the seller delivers when he places the goods at the disposal of the buyer at the seller's premises or another named place (i.e. works, factory, warehouse, etc.) not cleared for export and not loaded on any collecting vehicle. This term thus represents the minimum obligation for the seller, and the buyer has to bear all costs and risks involved in taking the goods from the seller's premises.

However, if the parties wish the seller to be responsible for the loading of the goods on departure and to bear the risks and all the costs of such loading, this should be made clear by adding explicit wording to this effect in the contract of sale[1] . This term should not be used when the buyer cannot carry out the export formalities directly or indirectly. In such circumstances, the FCA term should be used, provided the seller agrees that he will load at his cost and risk.

A The seller's obligations

B The buyer's obligations

A1 Provision of goods in conformity with the contract

The seller must provide the goods and the commercial invoice, or its equivalent electronic message, in conformity with the contract of sale and any other evidence of conformity which may be required by the contract.

B1 Payment of the price

The buyer must pay the price as provided in the contract of sale.

A2 Licences, authorizations and formalities

The seller must render the buyer, at the latter's request, risk and expense, every assistance in obtaining, where applicable,[2] any export licence or other official authorization necessary for the export of the goods.

B2 Licences, authorizations and formalities

The buyer must obtain at his own risk and expense any export and import licence or other official authorization and carry out, where applicable,[3] all customs formalities for the export of the goods.

A3 Contracts of carriage and insurance

(a) Contract of carriage

No obligation.[4]

(b) Contract of insurance

No obligation.[5]

B3 Contracts of carriage and insurance

(a) Contract of carriage

No obligation.[6]

(b) Contract of insurance

No obligation.[7]

A4 Delivery

The seller must place the goods at the disposal of the buyer at the named place of delivery, not loaded on any collecting vehicle, on the date or within the period agreed or, if no such time is agreed, at the usual time for delivery of such goods. If no specific point has been agreed within the named place, and if there are several points available, the seller may select the point at the place of delivery which best suits his purpose.

B4 Taking delivery

The buyer must take delivery of the goods when they have been delivered in accordance with A4 and A7/B7.

A5 Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have been delivered in accordance with A4.

B5 Transfer of risks

The buyer must bear all risks of loss of or damage to the goods

- from the time they have been delivered in accordance with A4; and
- from the agreed date or the expiry date of any period fixed for taking delivery which arise because he fails to give notice in accordance with B7, provided, however, that the goods have been duly appropriated to the contract, that is to say clearly set aside or otherwise identified as the contract goods.

A6 Division of costs

The seller must, subject to the provisions of B6, pay all costs relating to the goods until such time as they have been delivered in accordance with A4.

B6 Division of costs

The buyer must pay

- all costs relating to the goods from the time they have been delivered in accordance with A4; and
- any additional costs incurred by failing either to take delivery of the goods when they have been placed at his disposal, or to give appropriate notice in accordance with B7 provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods; and
- where applicable,[8] all duties, taxes and other charges as well as the costs of carrying out customs formalities payable upon export.

The buyer must reimburse all costs and charges incurred by the seller in rendering assistance in accordance with A2.

A7 Notice to the buyer

The seller must give the buyer sufficient notice as to when and where the goods will be placed at his disposal.

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[1] See Introduction, para. 11.

[2] Ibid., para. 14.

[3] Ibid.

[4] Ibid., para. 10.

[5] Ibid.

[6] Ibid.

[7] Ibid.

[8] Ibid., para. 14.

B7 Notice to the seller

The buyer must, whenever he is entitled to determine the time within an agreed period and/or the place of taking delivery, give the seller sufficient notice thereof.

A8 Proof of delivery, transport document or equivalent electronic message

No obligation.[9]

B8 Proof of delivery, transport document or equivalent electronic message

The buyer must provide the seller with appropriate evidence of having taken delivery.

A9 Checking—packaging—marking

The seller must pay the costs of those checking operations (such as checking quality, measuring, weighing, counting) which are necessary for the purpose of placing the goods at the buyer's disposal.

The seller must provide at his own expense packaging (unless it is usual for the particular trade to make the goods of the contract description available unpacked) which is required for the transport of the goods, to the extent that the circumstances relating to the transport (for example modalities, destination) are made known to the seller before the contract of sale is concluded. Packaging is to be marked appropriately.

B9 Inspection of goods

The buyer must pay the costs of any pre-shipment inspection, including inspection mandated by the authorities of the country of export.

A10 Other obligations

The seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages issued or transmitted in the country of delivery and/or of origin which the buyer may require for the export and/or import of the goods and, where necessary, for their transit through any country.

The seller must provide the buyer, upon request, with the necessary information for procuring insurance.

B10 Other obligations

The buyer must pay all costs and charges incurred in obtaining the documents or equivalent electronic messages mentioned in A10 and reimburse those incurred by the seller in rendering his assistance in accordance therewith.

FCA

Free carrier (... named place)

"Free Carrier" means that the seller delivers the goods, cleared for export, to the carrier nominated by the buyer at the named place. It should be noted that the chosen place of delivery has an impact on the obligations of loading and unloading the goods at that place. If delivery occurs at the seller's premises, the seller is responsible for loading. If delivery occurs at any other place, the seller is not responsible for unloading.

This term may be used irrespective of the mode of transport, including multimodel transport.

"Carrier" means any person who, in a contract of carriage, undertakes to perform or to procure the performance of transport by rail, road, air, sea, inland waterway or by a combination of such modes.

If the buyer nominates a person other than a carrier to receive the goods, the seller is deemed to have fulfilled his obligation to deliver the goods when they are delivered to that person.

A The seller's obligations

B The buyer's obligations

A1 Provision of goods in conformity with the contract

The seller must provide the goods and the commercial invoice, or its equivalent electronic message, in conformity with the contract of sale and any other evidence of conformity which may be required by the contract.

B1 Payment of the price

The buyer must pay the price as provided in the contract of sale.

A2 Licences, authorizations and formalities

The seller must obtain at his own risk and expense any export licence or other official authorization and carry out, where applicable,[10] all customs formalities necessary for the export of the goods.

B2 Licences, authorizations and formalities

The buyer must obtain at his own risk and expense any import licence or other official authorization and carry out, where applicable,[11] all customs formalities for the import of the goods and for their transit through any country.

A3 Contracts of carriage and insurance

(a) Contract of carriage

No obligation.[12]

However, if requested by the buyer or if it is commercial practice and the buyer does not give an instruction to the contrary in due time, the seller may contract for carriage on usual terms at the buyer's risk and expense. In either case, the seller may decline to make the contract and, if he does, shall promptly notify the buyer accordingly.

(b) *Contract of insurance*

No obligation.[13]

B3 Contracts of carriage and insurance

(a) *Contract of carriage*

The buyer must contract at his own expense for the carriage of the goods from the named place, except when the contract of carriage is made by the seller as provided for in A3 *(a).*

(b) *Contract of insurance*

No obligation.[14]

[9]Ibid., para. 10.

[10]Ibid., para. 14.

[11]Ibid.

[12]Ibid., para. 10.

[13]Ibid.

[14]Ibid.

A4 Delivery

The seller must deliver the goods to the carrier or another person nominated by the buyer, or chosen by the seller in accordance with A3 *(a)*, at the named place on the date or within the period agreed for delivery.

Delivery is completed:

(a) If the named place is the seller's premises, when the goods have been loaded on the means of transport provided by the carrier nominated by the buyer or another person acting on his behalf.

(b) If the named place is anywhere other than *(a)*, when the goods are placed at the disposal of the carrier or another person nominated by the buyer, or chosen by the seller in accordance with A3 *(a)* on the seller's means of transport not unloaded.

If no specific point has been agreed within the named place, and if there are several points available, the seller may select the point at the place of delivery which best suits his purpose.

Failing precise instructions from the buyer, the seller may deliver the goods for carriage in such a manner as the transport mode and/or the quantity and/or nature of the goods may require.

B4 Taking delivery

The buyer must take delivery of the goods when they have been delivered in accordance with A4.

A5 Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have been delivered in accordance with A4.

B5 Transfer of risks

The buyer must bear all risks of loss of or damage to the goods

- from the time they have been delivered in accordance with A4; and
- from the agreed date or the expiry date of any agreed period for delivery which arise either because he fails to nominate the carrier or another person in accordance with A4, or because the carrier or the party nominated by the buyer fails to take the goods into his charge at the agreed time, or because the buyer fails to give appropriate notice in accordance with B7, provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

A6 Division of costs

The seller must, subject to the provisions of B6, pay

- all costs relating to the goods until such time as they have been delivered in accordance with A4; and
- where applicable,[15] the costs of customs formalities as well as all duties, taxes, and other charges payable upon export.

B6 Division of costs

The buyer must pay

- all costs relating to the goods from the time they have been delivered in accordance with A4; and
- any additional costs incurred, either because he fails to nominate the carrier or another person in accordance with A4 or because the party nominated by the buyer fails to take the goods into his charge at the agreed time, or because he has failed to give appropriate notice in accordance with B7, provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods; and
- where applicable,[16] all duties, taxes and other charges as well as the costs of carrying out customs formalities payable upon import of the goods and for their transit through any country.

A7 Notice to the buyer

The seller must give the buyer sufficient notice that the goods have been delivered in accordance with A4. Should the carrier fail to take delivery in accordance with A4 at the time agreed, the seller must notify the buyer accordingly.

B7 Notice to the seller

The buyer must give the seller sufficient notice of the name of the party designated in A4 and, where necessary, specify the mode of transport, as well as the date or period for delivering the goods to him and, as the case may be, the point within the place where the goods should be delivered to that party.

A8 Proof of delivery, transport document or equivalent electronic message

The seller must provide the buyer at the seller's expense with the usual proof of delivery of the goods in accordance with A4.

Unless the document referred to in the preceding paragraph is the transport document, the seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining a transport document for the contract of carriage (for example a negotiable bill of lading, a non-negotiable sea waybill, an inland waterway document, an air waybill, a railway consignment note, a road consignment note, or a multimodal transport document).

When the seller and the buyer have agreed to communicate electronically, the document referred to in the preceding paragraph may be replaced by an equivalent electronic data interchange (EDI) message.

B8 Proof of delivery, transport document or equivalent electronic message

The buyer must accept the proof of delivery in accordance with A8.

A9 Checking—packaging—marking

The seller must pay the costs of those checking operations (such as checking quality, measuring, weighing, counting) which are necessary for the purpose of delivering the goods in accordance with A4.

The seller must provide at his own expense packaging (unless it is usual for the particular trade to send the goods of the contract description unpacked) which is required for the transport of the goods, to the extent that the circumstances relating to the transport (for example modalities, destination) are made known to the seller before the contract of sale is concluded. Packaging is to be marked appropriately.

B9 Inspection of goods

The buyer must pay the costs of any pre-shipment inspection except when such inspection is mandated by the authorities of the country of export.

[15] Ibid., para. 14.

[16] Ibid.

A10 Other obligations

The seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages (other than those mentioned in A8) issued or transmitted in the country of delivery and/or of origin which the buyer may require for the import of the goods and, where necessary, for their transit through any country.

The seller must provide the buyer, upon request, with the necessary information for procuring insurance.

B10 Other obligations

The buyer must pay all costs and charges incurred in obtaining the documents or equivalent electronic messages mentioned in A10 and reimburse those incurred by the seller in rendering his assistance in accordance therewith and in contracting for carriage in accordance with A3 *(a).*

The buyer must give the seller appropriate instructions whenever the seller's assistance in contracting for carriage is required in accordance with A3 *(a).*

FAS

Free alongside ship (... named port of shipment)

"Free Alongside Ship" means that the seller delivers when the goods are placed alongside the vessel at the named port of shipment. This means that the buyer has to bear all costs and risks of loss of or damage to the goods from that moment.

The FAS term requires the seller to clear the goods for export.

THIS IS A REVERSAL FROM PREVIOUS INCOTERMS VERSIONS WHICH REQUIRED THE BUYER TO ARRANGE FOR EXPORT CLEARANCE.

However, if the parties wish the buyer to clear the goods for export, this should be made clear by adding explicit wording to this effect in the contract of sale.[17]

This term can be used only for sea or inland waterway transport.

A The seller's obligations

B The buyer's obligations

A1 Provision of goods in conformity with the contract

The seller must provide the goods and the commercial invoice, or its equivalent electronic message, in conformity with the contract of sale and any other evidence of conformity which may be required by the contract.

B1 Payment of the price

The buyer must pay the price as provided in the contract of sale.

A2 Licences, authorizations and formalities

The seller must obtain at his own risk and expense any export licence or other official authorization and carry out, where applicable,[18] all customs formalities necessary for the export of the goods.

[17]Ibid., para. 11.

[18]Ibid., para. 14.

B2 Licences, authorizations and formalities

The buyer must obtain at his own risk and expense any import licence or other official authorization and carry out, where applicable,[19] all customs formalities for the import of the goods and for their transit through any country.

A3 Contracts of carriage and insurance

(a) Contract of carriage

No obligation.[20]

(b) *Contract of insurance*

No obligation.[21]

B3 Contracts of carriage and insurance

(a) *Contract of carriage*

The buyer must contract at his own expense for the carriage of the goods from the named port of shipment.

(b) *Contract of insurance*

No obligation.[22]

A4 Delivery

The seller must place the goods alongside the vessel nominated by the buyer at the loading place named by the buyer at the named port of shipment on the date or within the agreed period and in the manner customary at the port.

B4 Taking delivery

The buyer must take delivery of the goods when they have been delivered in accordance with A4.

A5 Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have been delivered in accordance with A4.

B5 Transfer of risks

The buyer must bear all risks of loss of or damage to the goods

- from the time they have been delivered in accordance with A4; and
- from the agreed date or the expiry date of the agreed period for delivery which arise because he fails to give notice in accordance with B7, or because the vessel nominated by him fails to arrive on time, or is unable to take the goods, or closes for cargo earlier than the time notified in accordance with B7, provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

A6 Division of costs

The seller must, subject to the provisions of B6, pay

- all costs relating to the goods until such time as they have been delivered in accordance with A4; and
- where applicable,[23] the costs of customs formalities as well as all duties, taxes, and other charges payable upon export.

[19]Ibid., para. 14.

[20]Ibid., para. 10.

[21]Ibid.

[22]Ibid.

[23]Ibid., para. 14.

B6 Division of costs

The buyer must pay

- all costs relating to the goods from the time they have been delivered in accordance with A4; and
- any additional costs incurred, either because the vessel nominated by him has failed to arrive on time, or is unable to take the goods, or closes for cargo earlier than the time notified in accordance with B7, or because the buyer has failed to give appropriate notice in accordance with B7 provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods; and
- where applicable,[24] all duties, taxes and other charges as well as the costs of carrying out customs formalities payable upon import of the goods and for their transit through any country.

A7 Notice to the buyer

The seller must give the buyer sufficient notice that the goods have been delivered alongside the nominated vessel.

B7 Notice to the seller

The buyer must give the seller sufficient notice of the vessel name, loading point and required delivery time.

A8 Proof of delivery, transport document or equivalent electronic message

The seller must provide the buyer at the seller's expense with the usual proof of delivery of the goods in accordance with A4.

Unless the document referred to in the preceding paragraph is the transport document, the seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining a transport document (for example a negotiable bill of lading, a non-negotiable sea waybill, an inland waterway document).

When the seller and the buyer have agreed to communicate electronically, the document referred to in the preceding paragraphs may be replaced by an equivalent electronic data interchange (EDI) message.

B8 Proof of delivery, transport document or equivalent electronic message

The buyer must accept the proof of delivery in accordance with A8.

A9 Checking—packaging—marking

The seller must pay the costs of those checking operations (such as checking quality, measuring, weighing, counting) which are necessary for the purpose of delivering the goods in accordance with A4.

The seller must provide at his own expense packaging (unless it is usual for the particular trade to ship the goods of the contract description unpacked) which is required for the transport of the goods, to the extent that the circumstances relating to the transport (for example modalities, destination) are made known to the seller before the contract of sale is concluded. Packaging is to be marked appropriately.

B9 Inspection of goods

The buyer must pay the costs of any pre-shipment inspection, except when such inspection is mandated by the authorities of the country of export.

[24]Ibid., para. 14.

A10 Other obligations

The seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages (other than those mentioned in A8) issued or transmitted in the country of shipment and/or of origin which the buyer may require for the import of the goods and, where necessary, for their transit through any country.

The seller must provide the buyer, upon request, with the necessary information for procuring insurance.

B10 Other obligations

The buyer must pay all costs and charges incurred in obtaining the documents or equivalent electronic messages mentioned in A10 and reimburse those incurred by the seller in rendering his assistance in accordance therewith.

FOB

Free on board (... named port of shipment)

"Free on Board" means that the seller delivers when the goods pass the ship's rail at the named port of shipment. This means that the buyer has to bear all costs and risks of loss of or damage to the goods from that point. The FOB term requires the seller to clear the goods for export. This term can be used only for sea or inland waterway transport. If the parties do not intend to deliver the goods across the ship's rail, the FCA term should be used.

A The seller's obligations

B The buyer's obligations

A1 Provision of goods in conformity with the contract

The seller must provide the goods and the commercial invoice, or its equivalent electronic message, in conformity with the contract of sale and any other evidence of conformity which may be required by the contract.

B1 Payment of the price

The buyer must pay the price as provided in the contract of sale.

A2 Licences, authorizations and formalities

The seller must obtain at his own risk and expense any export licence or other official authorization and carry out, where applicable,[25] all customs formalities necessary for the export of the goods.

B2 Licences, authorizations and formalities

The buyer must obtain at his own risk and expense any import licence or other official authorization and carry out, where applicable,[26] all customs formalities for the import of the goods and, where necessary, for their transit through any country.

A3 Contracts of carriage and insurance

(a) *Contract of carriage*

No obligation.[27]

(b) *Contract of insurance*

No obligation.[28]

[25]Ibid., para. 14.

[26]Ibid.

[27]Ibid., para. 10.

[28]Ibid.

B3 Contracts of carriage and insurance

(a) *Contract of carriage*

The buyer must contract at his own expense for the carriage of the goods from the named port of shipment.

(b) *Contract of insurance*

No obligation.[29]

A4 Delivery

The seller must deliver the goods on the date or within the agreed period at the named port of shipment and in the manner customary at the port on board the vessel nominated by the buyer.

B4 Taking delivery

The buyer must take delivery of the goods when they have been delivered in accordance with A4.

A5 Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have passed the ship's rail at the named port of shipment.

B5 Transfer of risks

The buyer must bear all risks of loss of or damage to the goods

- from the time they have passed the ship's rail at the named port of shipment; and
- from the agreed date or the expiry date of the agreed period for delivery which arise because he fails to give notice in accordance with B7, or because the vessel nominated by him fails to arrive on time, or is unable to take the goods, or closes for cargo earlier than the time notified in accordance with B7, provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

A6 Division of costs

The seller must, subject to the provisions of B6, pay

- all costs relating to the goods until such time as they have passed the ship's rail at the named port of shipment; and
- where applicable,[30] the costs of customs formalities necessary for export as well as all duties, taxes and other charges payable upon export.

B6 Division of costs

The buyer must pay

- all costs relating to the goods from the time they have passed the ship's rail at the named port of shipment; and
- any additional costs incurred, either because the vessel nominated by him fails to arrive on time, or is unable to take the goods, or closes for cargo earlier than the time notified in accordance with B7, or because the buyer has failed to give appropriate notice in accordance with B7, provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods; and
- where applicable,[31] all duties, taxes and other charges as well as the costs of carrying out customs formalities payable upon import of the goods and for their transit through any country.

[29]Ibid., para. 10.

[30]Ibid., para. 14.

[31]Ibid.

A7 Notice to the buyer

The seller must give the buyer sufficient notice that the goods have been delivered in accordance with A4.

B7 Notice to the seller

The buyer must give the seller sufficient notice of the vessel name, loading point and required delivery time.

A8 Proof of delivery, transport document or equivalent electronic message

The seller must provide the buyer at the seller's expense with the usual proof of delivery in accordance with A4.

Unless the document referred to in the preceding paragraph is the transport document, the seller must render the buyer, at the latter's request, risk and expense, every assistance in obtaining a transport document for the contract of carriage (for example, a negotiable bill of lading, a non-negotiable sea waybill, an inland waterway document, or a multimodal transport document).

Where the seller and the buyer have agreed to communicate electronically, the document referred to in the preceding paragraph may be replaced by an equivalent electronic data interchange (EDI) message.

B8 Proof of delivery, transport document or equivalent electronic message

The buyer must accept the proof of delivery in accordance with A8.

A9 Checking—packaging—marking

The seller must pay the costs of those checking operations (such as checking quality, measuring, weighing, counting) which are necessary for the purpose of delivering the goods in accordance with A4.

The seller must provide at his own expense packaging (unless it is usual for the particular trade to ship the goods of the contract description unpacked) which is required for the transport of the goods, to the extent that the circumstances relating to the transport (for example modalities, destination) are made known to the seller before the contract of sale is concluded. Packaging is to be marked appropriately.

B9 Inspection of goods

The buyer must pay the costs of any pre-shipment inspection except when such inspection is mandated by the authorities of the country of export.

A10 Other obligations

The seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages (other than those mentioned in A8) issued or transmitted in the country of shipment and/or of origin which the buyer may require for the import of the goods and, where necessary, for their transit through any country.

The seller must provide the buyer, upon request, with the necessary information for procuring insurance.

B10 Other obligations

The buyer must pay all costs and charges incurred in obtaining the documents or equivalent electronic messages mentioned in A10 and reimburse those incurred by the seller in rendering his assistance in accordance therewith.

CFR

Cost and freight (... named port of destination)

"Cost and Freight" means that the seller delivers when the goods pass the ship's rail in the port of shipment.

The seller must pay the costs and freight necessary to bring the goods to the named port of destination BUT the risk of loss of or damage to the goods, as well as any additional costs due to events occurring after the time of delivery, are transferred from the seller to the buyer.

The CFR term requires the seller to clear the goods for export.

This term can be used only for sea and inland waterway transport. If the parties do not intend to deliver the goods across the ship's rail, the CPT term should be used.

A The seller's obligations

B The buyer's obligations

A1 Provision of goods in conformity with the contract

The seller must provide the goods and the commercial invoice, or its equivalent electronic message, in conformity with the contract of sale and any other evidence of conformity which may be required by the contract.

B1 Payment of the price

The buyer must pay the price as provided in the contract of sale.

A2 Licences, authorizations and formalities

The seller must obtain at his own risk and expense any export licence or other official authorization and carry out, where applicable,[32] all customs formalities necessary for the export of the goods.

B2 Licences, authorizations and formalities

The buyer must obtain at his own risk and expense any import licence or other official authorization and carry out, where applicable,[33] all customs formalities for the import of the goods and for their transit through any country.

A3 Contracts of carriage and insurance

(a) *Contract of carriage*

The seller must contract on usual terms at his own expense for the carriage of the goods to the named port of destination by the usual route in a seagoing vessel (or inland waterway vessel as the case may be) of the type normally used for the transport of goods of the contract description.

(b) *Contract of insurance*

No obligation.[34]

B3 Contracts of carriage and insurance

(a) *Contract of carriage*

No obligation.[35]

(b) *Contract of insurance*

No obligation.[36]

A4 Delivery

The seller must deliver the goods on board the vessel at the port of shipment on the date or within the agreed period.

B4 Taking delivery

The buyer must accept delivery of the goods when they have been delivered in accordance with A4 and receive them from the carrier at the named port of destination.

A5 Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have passed the ship's rail at the port of shipment.

B5 Transfer of risks

The buyer must bear all risks of loss of or damage to the goods from the time they have passed the ship's rail at the port of shipment.

The buyer must, should he fail to give notice in accordance with B7, bear all risks of loss of or damage to the goods from the agreed date or the expiry date of the period fixed for shipment provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

A6 Division of costs

The seller must, subject to the provisions of B6, pay

- all costs relating to the goods until such time as they have been delivered in accordance with A4; and
- the freight and all other costs resulting from A3 *(a),* including the costs of loading the goods on board and any charges for unloading at the agreed port of discharge which were for the seller's account under the contract of carriage; and
- where applicable,[37] the costs of customs formalities necessary for export as well as all duties, taxes and other charges payable upon export, and for their transit through any country if they were for the seller's account under the contract of carriage.

B6 Division of costs

The buyer must, subject to the provisions of A3 *(a),* pay

- all costs relating to the goods from the time they have been delivered in accordance with A4; and
- all costs and charges relating to the goods whilst in transit until their arrival at the port of destination, unless such costs and charges were for the seller's account under the contract of carriage; and
- unloading costs including lighterage and wharfage charges, unless such costs and charges were for the seller's account under the contract of carriage; and
- all additional costs incurred if he fails to give notice in accordance with B7, for the goods from the agreed date or the expiry date of the period fixed for shipment, provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods; and

[32]Ibid., para. 14.

[33]Ibid.

[34]Ibid., para. 10.

[35]Ibid.

[36]Ibid., para. 10.

[37]Ibid., para. 14.

- where applicable,[38] all duties, taxes and other charges as well as the costs of carrying out customs formalities payable upon import of the goods and, where necessary, for their transit through any country unless included within the cost of the contract of carriage.

A7 Notice to the buyer

The seller must give the buyer sufficient notice that the goods have been delivered in accordance with A4 as well as any other notice required in order to allow the buyer to take measures which are normally necessary to enable him to take the goods.

B7 Notice to the seller

The buyer must, whenever he is entitled to determine the time for shipping the goods and/or the port of destination, give the seller sufficient notice thereof.

A8 Proof of delivery, transport document or equivalent electronic message

The seller must at his own expense provide the buyer without delay with the usual transport document for the agreed port of destination.

This document (for example a negotiable bill of lading, a non-negotiable sea waybill or an inland waterway document) must cover the contract goods, be dated within the period agreed for shipment, enable the buyer to claim the goods from the carrier at the port of destination and, unless otherwise agreed, enable the buyer to sell the goods in transit by the transfer of the document to a subsequent buyer (the negotiable bill of lading) or by notification to the carrier.

When such a transport document is issued in several originals, a full set of originals must be presented to the buyer.

Where the seller and the buyer have agreed to communicate electronically, the document referred to in the preceding paragraphs may be replaced by an equivalent electronic data interchange (EDI) message.

B8 Proof of delivery, transport document or equivalent electronic message

The buyer must accept the transport document in accordance with A8 if it is in conformity with the contract.

A9 Checking—packaging—marking

The seller must pay the costs of those checking operations (such as checking quality, measuring, weighing, counting) which are necessary for the purpose of delivering the goods in accordance with A4.

The seller must provide at his own expense packaging (unless it is usual for the particular trade to ship the goods of the contract description unpacked) which is required for the transport of the goods arranged by him. Packaging is to be marked appropriately.

B9 Inspection of goods

The buyer must pay the costs of any pre-shipment inspection except when such inspection is mandated by the authorities of the country of export.

A10 Other obligations

The seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages (other than those mentioned in A8) issued or transmitted in the country of shipment and/or of origin which the buyer may require for the import of the goods and, where necessary, for their transit through any country.

The seller must provide the buyer, upon request, with the necessary information for procuring insurance.

B10 Other obligations

The buyer must pay all costs and charges incurred in obtaining the documents or equivalent electronic messages mentioned in A10 and reimburse those incurred by the seller in rendering his assistance in accordance therewith.

CIF

Cost, insurance and freight (... named port of destination)

"Cost, Insurance and Freight" means that the seller delivers when the goods pass the ship's rail in the port of shipment.

The seller must pay the costs and freight necessary to bring the goods to the named port of destination BUT the risk of loss of or damage to the goods, as well as any additional costs due to events occurring after the time of delivery, are transferred from the seller to the buyer. However, in CIF the seller also has to procure marine insurance against the buyer's risk of loss of or damage to the goods during the carriage.

Consequently, the seller contracts for insurance and pays the insurance premium. The buyer should note that under the CIF term the seller is required to obtain insurance only on minimum cover.[39] Should the buyer wish to have the protection of greater cover, he would either need to agree as much expressly with the seller or to make his own extra insurance arrangements.

The CIF term requires the seller to clear the goods for export.

This term can be used only for sea and inland waterway transport. If the parties do not intend to deliver the goods across the ship's rail, the CIP term should be used.

A The seller's obligations

B The buyer's obligations

A1 Provision of goods in conformity with the contract

The seller must provide the goods and the commercial invoice, or its equivalent electronic message, in conformity with the contract of sale and any other evidence of conformity which may be required by the contract.

B1 Payment of the price

The buyer must pay the price as provided in the contract of sale.

A2 Licences, authorizations and formalities

The seller must obtain at his own risk and expense any export licence or other official authorization and carry out, where applicable,[40] all customs formalities necessary for the export of the goods.

B2 Licences, authorizations and formalities

The buyer must obtain at his own risk and expense any import licence or other official authorization and carry out, where appli-

[38] Ibid., para. 14.

[39] Ibid., para. 9.3.

[40] Ibid., para. 14.

cable,[41] all customs formalities for the import of the goods and for their transit through any country.

A3 Contracts of carriage and insurance

(a) Contract of carriage

The seller must contract on usual terms at his own expense for the carriage of the goods to the named port of destination by the usual route in a seagoing vessel (or inland waterway vessel as the case may be) of the type normally used for the transport of goods of the contract description.

(b) Contract of insurance

The seller must obtain at his own expense cargo insurance as agreed in the contract, such that the buyer, or any other person having an insurable interest in the goods, shall be entitled to claim directly from the insurer and provide the buyer with the insurance policy or other evidence of insurance cover.

The insurance shall be contracted with underwriters or an insurance company of good repute and, failing express agreement to the contrary, be in accordance with minimum cover of the Institute Cargo Clauses (Institute of London Underwriters) or any similar set of clauses. The duration of insurance cover shall be in accordance with B5 and B4. When required by the buyer, the seller shall provide at the buyer's expense war, strikes, riots and civil commotion risk insurances if procurable. The minimum insurance shall cover the price provided in the contract plus 10 per cent (i.e. 110 per cent) and shall be provided in the currency of the contract.

B3 Contracts of carriage and insurance

(a) Contract of carriage

No obligation.[42]

(b) Contract of insurance

No obligation.[43]

A4 Delivery

The seller must deliver the goods on board the vessel at the port of shipment on the date or within the agreed period.

B4 Taking delivery

The buyer must accept delivery of the goods when they have been delivered in accordance with A4 and receive them from the carrier at the named port of destination.

A5 Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have passed the ship's rail at the port of shipment.

B5 Transfer of risks

The buyer must bear all risks of loss of or damage to the goods from the time they have passed the ship's rail at the port of shipment.

The buyer must, should he fail to give notice in accordance with B7, bear all risks of loss of or damage to the goods from the agreed date or the expiry date of the period fixed for shipment provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

[41]Ibid., para. 14.

[42]Ibid., para. 10.

[43]Ibid.

A6 Division of costs

The seller must, subject to the provisions of B6, pay

- all costs relating to the goods until such time as they have been delivered in accordance with A4; and
- the freight and all other costs resulting from A3 *(a),* including the costs of loading the goods on board;
- and the costs of insurance resulting from A3 *(b);* and
- any charges for unloading at the agreed port of discharge which were for the seller's account under the contract of carriage; and
- where applicable,[44] the costs of customs formalities necessary for export as well as all duties, taxes and other charges payable upon export, and for their transit through any country if they were for the seller's account under the contract of carriage.

B6 Division of costs

The buyer must, subject to the provisions of A3, pay

- all costs relating to the goods from the time they have been delivered in accordance with A4; and
- all costs and charges relating to the goods whilst in transit until their arrival at the port of destination, unless such costs and charges were for the seller's account under the contract of carriage; and
- unloading costs including lighterage and wharfage charges, unless such costs and charges were for the seller's account under the contract of carriage; and
- all additional costs incurred if he fails to give notice in accordance with B7, for the goods from the agreed date or the expiry date of the period fixed for shipment, provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods; and
- where applicable,[45] all duties, taxes and other charges as well as the costs of carrying out customs formalities payable upon import of the goods and, where necessary, for their transit through any country unless included within the cost of the contract of carriage.

A7 Notice to the buyer

The seller must give the buyer sufficient notice that the goods have been delivered in accordance with A4 as well as any other notice required in order to allow the buyer to take measures which are normally necessary to enable him to take the goods.

B7 Notice to the seller

The buyer must, whenever he is entitled to determine the time for shipping the goods and/or the port of destination, give the seller sufficient notice thereof.

A8 Proof of delivery, transport document or equivalent electronic message

The seller must, at his own expense, provide the buyer without delay with the usual transport document for the agreed port of destination.

This document (for example a negotiable bill of lading, a non-negotiable sea waybill or an inland waterway document) must cover the contract goods, be dated within the period agreed for shipment, enable the buyer to claim the goods from the carrier at the port of destination and, unless otherwise agreed, enable the

[44]Ibid., para. 14.

[45]Ibid.

buyer to sell the goods in transit by the transfer of the document to a subsequent buyer (the negotiable bill of lading) or by notification to the carrier.

When such a transport document is issued in several originals, a full set of originals must be presented to the buyer.

Where the seller and the buyer have agreed to communicate electronically, the document referred to in the preceding paragraphs may be replaced by an equivalent electronic data interchange (EDI) message.

B8 Proof of delivery, transport document or equivalent electronic message

The buyer must accept the transport document in accordance with A8 if it is in conformity with the contract.

A9 Checking—packaging—marking

The seller must pay the costs of those checking operations (such as checking quality, measuring, weighing, counting) which are necessary for the purpose of delivering the goods in accordance with A4.

The seller must provide at his own expense packaging (unless it is usual for the particular trade to ship the goods of the contract description unpacked) which is required for the transport of the goods arranged by him. Packaging is to be marked appropriately.

B9 Inspection of goods

The buyer must pay the costs of any pre-shipment inspection except when such inspection is mandated by the authorities of the country of export.

A10 Other obligations

The seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages (other than those mentioned in A8) issued or transmitted in the country of shipment and/or of origin which the buyer may require for the import of the goods and, where necessary, for their transit through any country.

The seller must provide the buyer, upon request, with the necessary information for procuring any additional insurance.

B10 Other obligations

The buyer must pay all costs and charges incurred in obtaining the documents or equivalent electronic messages mentioned in A10 and reimburse those incurred by the seller in rendering his assistance in accordance therewith.

The buyer must provide the seller, upon request, with the necessary information for procuring insurance.

CPT

Carriage paid to (... named place of destination)

"Carriage Paid to..." means that the seller delivers the goods to the carrier nominated by him but the seller must in addition pay the cost of carriage necessary to bring the goods to the named destination. This means that the buyer bears all risks and any other costs occurring after the goods have been so delivered.

"Carrier" means any person who, in a contract of carriage, undertakes to perform or to procure the performance of transport, by rail, road, air, sea, inland waterway or by a combination of such modes. If subsequent carriers are used for the carriage to the agreed destination, the risk passes when the goods have been delivered to the first carrier.

The CPT term requires the seller to clear the goods for export.

This term may be used irrespective of the mode of transport including multimodal transport.

A The seller's obligations

B The buyer's obligations

A1 Provision of goods in conformity with the contract

The seller must provide the goods and the commercial invoice, or its equivalent electronic message, in conformity with the contract of sale and any other evidence of conformity which may be required by the contract.

B1 Payment of the price

The buyer must pay the price as provided in the contract of sale.

A2 Licences, authorizations and formalities

The seller must obtain at his own risk and expense any export licence or other official authorization and carry out, where applicable,[46] all customs formalities necessary for the export of the goods.

B2 Licences, authorizations and formalities

The buyer must obtain at his own risk and expense any import licence or other official authorization and carry out, where applicable,[47] all customs formalities for the import of the goods and for their transit through any country.

A3 Contracts of carriage and insurance

(a) Contract of carriage

The seller must contract on usual terms at his own expense for the carriage of the goods to the agreed point at the named place of destination by a usual route and in a customary manner. If a point is not agreed or is not determined by practice, the seller may select the point at the named place of destination which best suits his purpose.

(b) Contract of insurance

No obligation[48]

B3 Contracts of carriage and insurance

(a) Contract of carriage

No obligation.[49]

(b) Contract of insurance

No obligation.[50]

A4 Delivery

The seller must deliver the goods to the carrier contracted in accordance with A3 or, if there are subsequent carriers to the first carrier, for transport to the agreed point at the named place on the date or within the agreed period.

[46]Ibid., para. 14.

[47]Ibid.

[48]Ibid., para. 10.

[49]Ibid.

[50]Ibid.

B4 Taking delivery

The buyer must accept delivery of the goods when they have been delivered in accordance with A4 and receive them from the carrier at the named place.

A5 Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have been delivered in accordance with A4.

B5 Transfer of risks

The buyer must bear all risks of loss of or damage to the goods from the time they have been delivered in accordance with A4.

The buyer must, should he fail to give notice in accordance with B7, bear all risks of the goods from the agreed date or the expiry date of the period fixed for delivery provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

A6 Division of costs

The seller must, subject to the provisions of B6, pay

- all costs relating to the goods until such time as they have been delivered in accordance with A4 as well as the freight and all other costs resulting from A3 *(a)*, including the costs of loading the goods and any charges for unloading at the place of destination which were for the seller's account under the contract of carriage; and
- where applicable,[51] the costs of customs formalities necessary for export as well as all duties, taxes or other charges payable upon export, and for their transit through any country if they were for the seller's account under the contract of carriage.

B6 Division of costs

The buyer must, subject to the provisions of A3 *(a)*, pay

- all costs relating to the goods from the time they have been delivered in accordance with A4; and
- all costs and charges relating to the goods whilst in transit until their arrival at the agreed place of destination, unless such costs and charges were for the seller's account under the contract of carriage; and
- unloading costs unless such costs and charges were for the seller's account under the contract of carriage; and
- all additional costs incurred if he fails to give notice in accordance with B7, for the goods from the agreed date or the expiry date of the period fixed for dispatch, provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods; and
- where applicable,[52] all duties, taxes and other charges as well as the costs of carrying out customs formalities payable upon import of the goods and for their transit through any country unless included within the cost of the contract of carriage.

A7 Notice to the buyer

The seller must give the buyer sufficient notice that the goods have been delivered in accordance with A4 as well as any other notice required in order to allow the buyer to take measures which are normally necessary to enable him to take the goods.

[51]Ibid., para. 14.

[52]Ibid.

B7 Notice to the seller

The buyer must, whenever he is entitled to determine the time for dispatching the goods and/or the destination, give the seller sufficient notice thereof.

A8 Proof of delivery, transport document or equivalent electronic message

The seller must provide the buyer at the seller's expense, if customary, with the usual transport document or documents (for example a negotiable bill of lading, a non-negotiable sea waybill, an inland waterway document, an air waybill, a railway consignment note, a road consignment note, or a multimodal transport document) for the transport contracted in accordance with A3.

Where the seller and the buyer have agreed to communicate electronically, the document referred to in the preceding paragraph may be replaced by an equivalent electronic data interchange (EDI) message.

B8 Proof of delivery, transport document or equivalent electronic message

The buyer must accept the transport document in accordance with A8 if it is in conformity with the contract.

A9 Checking—packaging—marking

The seller must pay the costs of those checking operations (such as checking quality, measuring, weighing, counting) which are necessary for the purpose of delivering the goods in accordance with A4.

The seller must provide at his own expense packaging (unless it is usual for the particular trade to send the goods of the contract description unpacked) which is required for the transport of the goods arranged by him. Packaging is to be marked appropriately.

B9 Inspection of goods

The buyer must pay the costs of any pre-shipment inspection except when such inspection is mandated by the authorities of the country of export.

A10 Other obligations

The seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages (other than those mentioned in A8) issued or transmitted in the country of dispatch and/or of origin which the buyer may require for the import of the goods and for their transit through any country.

The seller must provide the buyer, upon request, with the necessary information for procuring insurance.

B10 Other obligations

The buyer must pay all costs and charges incurred in obtaining the documents or equivalent electronic messages mentioned in A10 and reimburse those incurred by the seller in rendering his assistance in accordance therewith.

CIP

Carriage and insurance paid to (... named place of destination)

"Carriage and Insurance Paid to..." means that the seller delivers the goods to the carrier nominated by him but the seller must in addition pay the cost of carriage necessary to bring the goods to

the named destination. This means that the buyer bears all risks and any additional costs occurring after the goods have been so delivered. However, in CIP the seller also has to procure insurance against the buyer's risk of loss of or damage to the goods during the carriage.

Consequently, the seller contracts for insurance and pays the insurance premium.

The buyer should note that under the CIP term the seller is required to obtain insurance only on minimum cover.[53] Should the buyer wish to have the protection of greater cover, he would either need to agree as much expressly with the seller or to make his own extra insurance arrangements.

"Carrier" means any person who, in a contract of carriage, undertakes to perform or to procure the performance of transport, by rail, road, air, sea, inland waterway or by a combination of such modes.

If subsequent carriers are used for the carriage to the agreed destination, the risk passes when the goods have been delivered to the first carrier.

The CIP term requires the seller to clear the goods for export.

This term may be used irrespective of the mode of transport including multimodal transport.

A The seller's obligations

B The buyer's obligations

A1 Provision of goods in conformity with the contract

The seller must provide the goods and the commercial invoice, or its equivalent electronic message, in conformity with the contract of sale and any other evidence of conformity which may be required by the contract.

B1 Payment of the price

The buyer must pay the price as provided in the contract of sale.

A2 Licences, authorizations and formalities

The seller must obtain at his own risk and expense any export licence or other official authorization and carry out, where applicable,[54] all customs formalities necessary for the export of the goods.

B2 Licences, authorizations and formalities

The buyer must obtain at his own risk and expense any import licence or other official authorization and carry out, where applicable,[55] all customs formalities for the import of the goods and for their transit through any country.

A3 Contracts of carriage and insurance

(a) Contract of carriage

The seller must contract on usual terms at his own expense for the carriage of the goods to the agreed point at the named place of destination by a usual route and in a customary manner. If a point is not agreed or is not determined by practice, the seller may select the point at the named place of destination which best suits his purpose.

[53]Ibid., para. 9.3.

[54]Ibid., para. 14.

[55]Ibid.

(b) Contract of insurance

The seller must obtain at his own expense cargo insurance as agreed in the contract, such that the buyer, or any other person having an insurable interest in the goods, shall be entitled to claim directly from the insurer and provide the buyer with the insurance policy or other evidence of insurance cover.

The insurance shall be contracted with underwriters or an insurance company of good repute and, failing express agreement to the contrary, be in accordance with minimum cover of the Institute Cargo Clauses (Institute of London Underwriters) or any similar set of clauses. The duration of insurance cover shall be in accordance with B5 and B4. When required by the buyer, the seller shall provide at the buyer's expense war, strikes, riots and civil commotion risk insurances if procurable. The minimum insurance shall cover the price provided in the contract plus 10 per cent (i.e. 110 per cent) and shall be provided in the currency of the contract.

B3 Contracts of carriage and insurance

(a) Contract of carriage

No obligation.[56]

(b) Contract of insurance

No obligation.[57]

A4 Delivery

The seller must deliver the goods to the carrier contracted in accordance with A3 or, if there are subsequent carriers to the first carrier, for transport to the agreed point at the named place on the date or within the agreed period.

B4 Taking delivery

The buyer must accept delivery of the goods when they have been delivered in accordance with A4 and receive them from the carrier at the named place.

A5 Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have been delivered in accordance with A4.

B5 Transfer of risks

The buyer must bear all risks of loss of or damage to the goods from the time they have been delivered in accordance with A4.

The buyer must, should he fail to give notice in accordance with B7, bear all risks of the goods from the agreed date or the expiry date of the period fixed for delivery provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

A6 Division of costs

The seller must, subject to the provisions of B6, pay

- all costs relating to the goods until such time as they have been delivered in accordance with A4 as well as the freight and all other costs resulting from A3 *(a)*, including the costs of loading the goods and any charges for unloading at the place of destination which were for the seller's account under the contract of carriage; and
- the costs of insurance resulting from A3 *(b);* and

[56]Ibid., para. 10.

[57]Ibid.

- where applicable,[58] the costs of customs formalities necessary for export as well as all duties, taxes or other charges payable upon export, and for their transit through any country if they were for the seller's account under the contract of carriage.

B6 Division of costs

The buyer must, subject to the provisions of A3 *(a)*, pay

- all costs relating to the goods from the time they have been delivered in accordance with A4; and
- all costs and charges relating to the goods whilst in transit until their arrival at the agreed place of destination, unless such costs and charges were for the seller's account under the contract of carriage; and
- unloading costs unless such costs and charges were for the seller's account under the contract of carriage; and
- all additional costs incurred if he fails to give notice in accordance with B7, for the goods from the agreed date or the expiry date of the period fixed for dispatch, provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods; and
- where applicable,[59] all duties, taxes and other charges as well as the costs of carrying out customs formalities payable upon import of the goods and for their transit through any country unless included within the cost of the contract of carriage.

A7 Notice to the buyer

The seller must give the buyer sufficient notice that the goods have been delivered in accordance with A4 as well as any other notice required in order to allow the buyer to take measures which are normally necessary to enable him to take the goods.

B7 Notice to the seller

The buyer must, whenever he is entitled to determine the time for dispatching the goods and/or the destination, give the seller sufficient notice thereof.

A8 Proof of delivery, transport document or equivalent electronic message

The seller must provide the buyer at the seller's expense, if customary, with the usual transport document or documents (for example a negotiable bill of lading, a non-negotiable sea waybill, an inland waterway document, an air waybill, a railway consignment note, a road consignment note, or a multimodal transport document) for the transport contracted in accordance with A3.

Where the seller and the buyer have agreed to communicate electronically, the document referred to in the preceding paragraph may be replaced by an equivalent electronic data interchange (EDI) message.

B8 Proof of delivery, transport document or equivalent electronic message

The buyer must accept the transport document in accordance with A8 if it is in conformity with the contract.

A9 Checking—packaging—marking

The seller must pay the costs of those checking operations (such as checking quality, measuring, weighing, counting) which are necessary for the purpose of delivering the goods in accordance with A4.

The seller must provide at his own expense packaging (unless it is usual for the particular trade to send the goods of the contract description unpacked) which is required for the transport of the goods arranged by him. Packaging is to be marked appropriately.

B9 Inspection of goods

The buyer must pay the costs of any pre-shipment inspection except when such inspection is mandated by the authorities of the country of export.

A10 Other obligations

The seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages (other than those mentioned in A8) issued or transmitted in the country of dispatch and/or of origin which the buyer may require for the import of the goods and for their transit through any country.

The seller must provide the buyer, upon request, with the necessary information for procuring any additional insurance.

B10 Other obligations

The buyer must pay all costs and charges incurred in obtaining the documents or equivalent electronic messages mentioned in A10 and reimburse those incurred by the seller in rendering his assistance in accordance therewith.

The buyer must provide the seller, upon request, with the necessary information for procuring any additional insurance.

DAF

Delivered at frontier (... named place)

"Delivered at Frontier" means that the seller delivers when the goods are placed at the disposal of the buyer on the arriving means of transport not unloaded, cleared for export, but not cleared for import at the named point and place at the frontier, but before the customs border of the adjoining country. The term "frontier" may be used for any frontier including that of the country of export. Therefore, it is of vital importance that the frontier in question be defined precisely by always naming the point and place in the term.

However, if the parties wish the seller to be responsible for the unloading of the goods from the arriving means of transport and to bear the risks and costs of unloading, this should be made clear by adding explicit wording to this effect in the contract of sale.[60]

This term may be used irrespective of the mode of transport when goods are to be delivered at a land frontier. When delivery is to take place in the port of destination, on board a vessel or on the quay (wharf), the DES or DEQ terms should be used.

A The seller's obligations

B The buyer's obligations

A1 Provision of goods in conformity with the contract

The seller must provide the goods and the commercial invoice, or its equivalent electronic message, in conformity with the contract of sale and any other evidence of conformity which may be required by the contract.

[58]Ibid., para. 14.

[59]Ibid.

[60]Ibid., para. 11.

B1 Payment of the price

The buyer must pay the price as provided in the contract of sale.

A2 Licences, authorizations and formalities

The seller must obtain at his own risk and expense any export licence or other official authorization or other document necessary for placing the goods at the buyer's disposal.

The seller must carry out, where applicable,[61] all customs formalities necessary for the export of the goods to the named place of delivery at the frontier and for their transit through any country.

B2 Licences, authorizations and formalities

The buyer must obtain at his own risk and expense any import licence or other official authorization or other documents and carry out, where applicable,[62] all customs formalities necessary for the import of the goods, and for their subsequent transport.

A3 Contracts of carriage and insurance

(a) Contract of carriage

(i) The seller must contract at his own expense for the carriage of the goods to the named point, if any, at the place of delivery at the frontier. If a point at the named place of delivery at the frontier is not agreed or is not determined by practice, the seller may select the point at the named place of delivery which best suits his purpose.

(ii) However, if requested by the buyer, the seller may agree to contract on usual terms at the buyer's risk and expense for the on-going carriage of the goods beyond the named place at the frontier to the final destination in the country of import named by the buyer. The seller may decline to make the contract and, if he does, shall promptly notify the buyer accordingly.

(b) Contract of insurance

No obligation.[63]

B3 Contracts of carriage and insurance

(a) Contract of carriage

No obligation.[64]

(b) Contract of insurance

No obligation.[65]

A4 Delivery

The seller must place the goods at the disposal of the buyer on the arriving means of transport not unloaded at the named place of delivery at the frontier on the date or within the agreed period.

B4 Taking delivery

The buyer must take delivery of the goods when they have been delivered in accordance with A4.

A5 Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have been delivered in accordance with A4.

[61]Ibid., para. 14.

[62]Ibid.

[63]Ibid., para. 10.

[64]Ibid.

[65]Ibid.

B5 Transfer of risks

The buyer must bear all risks of loss of or damage to the goods from the time they have been delivered in accordance with A4.

The buyer must, should he fail to give notice in accordance with B7, bear all risks of loss of or damage to the goods from the agreed date or the expiry date of the agreed period for delivery provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

A6 Division of costs

The seller must, subject to the provisions of B6, pay

- in addition to the costs resulting from A3 *(a)*, all costs relating to the goods until such time as they have been delivered in accordance with A4; and
- where applicable,[66] the costs of customs formalities necessary for export as well as all duties, taxes or other charges payable upon export of the goods and for their transit through any country prior to delivery in accordance with A4.

B6 Division of costs

The buyer must pay

- all costs relating to the goods from the time they have been delivered in accordance with A4 including the expenses of unloading necessary to take delivery of the goods from the arriving means of transport at the named place of delivery at the frontier; and
- all additional costs incurred if he fails to take delivery of the goods when they have been delivered in accordance with A4, or to give notice in accordance with B7, provided, however, that the goods have been appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods; and
- where applicable,[67] the cost of customs formalities as well as all duties, taxes and other charges payable upon import of the goods and for their subsequent transport.

A7 Notice to the buyer

The seller must give the buyer sufficient notice of the dispatch of the goods to the named place at the frontier as well as any other notice required in order to allow the buyer to take measures which are normally necessary to enable him to take delivery of the goods.

B7 Notice to the seller

The buyer must, whenever he is entitled to determine the time within an agreed period and/or the point of taking delivery at the named place, give the seller sufficient notice thereof.

A8 Proof of delivery, transport document or equivalent electronic message

(i) The seller must provide the buyer at the seller's expense with the usual document or other evidence of the delivery of the goods at the named place at the frontier in accordance with A3 *(a)* (i).

(ii) The seller must, should the parties agree on on-going carriage beyond the frontier in accordance with A3 *(a)* (ii), provide the buyer at the latter's request, risk and expense, with the through document of transport normally obtained in the country of dis-

[66]Ibid., para. 14.

[67]Ibid.

patch covering on usual terms the transport of the goods from the point of dispatch in that country to the place of final destination in the country of import named by the buyer.

Where the seller and the buyer have agreed to communicate electronically, the document referred to in the preceding paragraph may be replaced by an equivalent electronic data interchange (EDI) message.

B8 Proof of delivery, transport document or equivalent electronic message

The buyer must accept the transport document and/or other evidence of delivery in accordance with A8.

A9 Checking—packaging—marking

The seller must pay the costs of those checking operations (such as checking quality, measuring, weighing, counting) which are necessary for the purpose of delivering the goods in accordance with A4.

The seller must provide at his own expense packaging (unless it is agreed or usual for the particular trade to deliver the goods of the contract description unpacked) which is required for the delivery of the goods at the frontier and for the subsequent transport to the extent that the circumstances (for example modalities, destination) are made known to the seller before the contract of sale is concluded. Packaging is to be marked appropriately.

B9 Inspection of goods

The buyer must pay the costs of any pre-shipment inspection except when such inspection is mandated by the authorities of the country of export.

A10 Other obligations

The seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages (other than those mentioned in A8) issued or transmitted in the country of dispatch and/or origin which the buyer may require for the import of the goods and, where necessary, for their transit through any country.

The seller must provide the buyer, upon request, with the necessary information for procuring insurance.

B10 Other obligations

The buyer must pay all costs and charges incurred in obtaining the documents or equivalent electronic messages mentioned in A10 and reimburse those incurred by the seller in rendering his assistance in accordance therewith.

If necessary, according to A3 *(a)* (ii), the buyer must provide the seller at his request and the buyer's risk and expense with the exchange control authorization, permits, other documents or certified copies thereof, or with the address of the final destination of the goods in the country of import for the purpose of obtaining the through document of transport or any other document contemplated in A8 (ii).

DES

Delivered ex ship (... named port of destination)

"Delivered Ex Ship" means that the seller delivers when the goods are placed at the disposal of the buyer on board the ship not cleared for import at the named port of destination. The seller has to bear all the costs and risks involved in bringing the goods to the named port of destination before discharging. If the parties wish the seller to bear the costs and risks of discharging the goods, then the DEQ term should be used.

This term can be used only when the goods are to be delivered by sea or inland waterway or multimodal transport on a vessel in the port of destination.

A The seller's obligations

B The buyer's obligations

A1 Provision of goods in conformity with the contract

The seller must provide the goods and the commercial invoice, or its equivalent electronic message, in conformity with the contract of sale and any other evidence of conformity which may be required by the contract.

B1 Payment of the price

The buyer must pay the price as provided in the contract of sale.

A2 Licences, authorizations and formalities

The seller must obtain at his own risk and expense any export licence or other official authorization or other documents and carry out, where applicable,[68] all customs formalities necessary for the export of the goods and for their transit through any country.

B2 Licences, authorizations and formalities

The buyer must obtain at his own risk and expense any import licence or other official authorization and carry out, where applicable,[69] all customs formalities necessary for the import of the goods.

A3 Contracts of carriage and insurance

(a) Contract of carriage

The seller must contract at his own expense for the carriage of the goods to the named point, if any, at the named port of destination. If a point is not agreed or is not determined by practice, the seller may select the point at the named port of destination which best suits his purpose.

(b) Contract of insurance

No obligation.[70]

B3 Contracts of carriage and insurance

(a) Contract of carriage

No obligation.[71]

(b) Contract of insurance

No obligation.[72]

A4 Delivery

The seller must place the goods at the disposal of the buyer on board the vessel at the unloading point referred to in A3 *(a)*, in the named port of destination on the date or within the agreed period, in such a way as to enable them to be removed from the vessel by unloading equipment appropriate to the nature of the goods.

[68]Ibid., para. 14.

[69]Ibid.

[70]Ibid., para. 10.

[71]Ibid.

[72]Ibid.

B4 Taking delivery

The buyer must take delivery of the goods when they have been delivered in accordance with A4.

A5 Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have been delivered in accordance with A4.

B5 Transfer of risks

The buyer must bear all risks of loss of or damage to the goods from the time they have been delivered in accordance with A4.

The buyer must, should he fail to give notice in accordance with B7, bear all risks of loss of or damage to the goods from the agreed date or the expiry date of the agreed period for delivery provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

A6 Division of costs

The seller must, subject to the provisions of B6, pay

- in addition to costs resulting from A3 *(a)*, all costs relating to the goods until such time as they have been delivered in accordance with A4; and
- where applicable,[73] the costs of customs formalities necessary for export as well as all duties, taxes or other charges payable upon export of the goods and for their transit through any country prior to delivery in accordance with A4.

B6 Division of costs

The buyer must pay

- all costs relating to the goods from the time they have been delivered in accordance with A4, including the expenses of discharge operations necessary to take delivery of the goods from the vessel; and
- all additional costs incurred if he fails to take delivery of the goods when they have been placed at his disposal in accordance with A4, or to give notice in accordance with B7, provided, however, that the goods have been appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods; and
- where applicable,[74] the costs of customs formalities as well as all duties, taxes and other charges payable upon import of the goods.

A7 Notice to the buyer

The seller must give the buyer sufficient notice of the estimated time of arrival of the nominated vessel in accordance with A4 as well as any other notice required in order to allow the buyer to take measures which are normally necessary to enable him to take delivery of the goods.

B7 Notice to the seller

The buyer must, whenever he is entitled to determine the time within an agreed period and/or the point of taking delivery in the named port of destination, give the seller sufficient notice thereof.

[73]Ibid., para. 14.

[74]Ibid.

A8 Proof of delivery, transport document or equivalent electronic message

The seller must provide the buyer at the seller's expense with the delivery order and/or the usual transport document (for example a negotiable bill of lading, a non-negotiable sea waybill, an inland waterway document, or a multimodal transport document) to enable the buyer to claim the goods from the carrier at the port of destination.

Where the seller and the buyer have agreed to communicate electronically, the document referred to in the preceding paragraph may be replaced by an equivalent electronic data interchange (EDI) message.

B8 Proof of delivery, transport document or equivalent electronic message

The buyer must accept the delivery order or the transport document in accordance with A8.

A9 Checking—packaging—marking

The seller must pay the costs of those checking operations (such as checking quality, measuring, weighing, counting) which are necessary for the purpose of delivering the goods in accordance with A4.

The seller must provide at his own expense packaging (unless it is usual for the particular trade to deliver the goods of the contract description unpacked) which is required for the delivery of the goods. Packaging is to be marked appropriately.

B9 Inspection of goods

The buyer must pay the costs of any pre-shipment inspection except when such inspection is mandated by the authorities of the country of export.

A10 Other obligations

The seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages (other than those mentioned in A8) issued or transmitted in the country of dispatch and/or of origin which the buyer may require for the import of the goods.

The seller must provide the buyer, upon request, with the necessary information for procuring insurance.

B10 Other obligations

The buyer must pay all costs and charges incurred in obtaining the documents or equivalent electronic messages mentioned in A10 and reimburse those incurred by the seller in rendering his assistance in accordance therewith.

DEQ

Delivered ex quay (... named port of destination)

"Delivered Ex Quay" means that the seller delivers when the goods are placed at the disposal of the buyer not cleared for import on the quay (wharf) at the named port of destination. The seller has to bear costs and risks involved in bringing the goods to the named port of destination and discharging the goods on the quay (wharf). The DEQ term requires the buyer to clear the goods for import and to pay for all formalities, duties, taxes and other charges upon import.

THIS IS A REVERSAL FROM PREVIOUS INCOTERMS VERSIONS WHICH REQUIRED THE SELLER TO ARRANGE FOR IMPORT CLEARANCE.

If the parties wish to include in the seller's obligations all or part of the costs payable upon import of the goods, this should be made clear by adding explicit wording to this effect in the contract of sale.[75]

This term can be used only when the goods are to be delivered by sea or inland waterway or multimodal transport on discharging from a vessel onto the quay (wharf) in the port of destination. However if the parties wish to include in the seller's obligations the risks and costs of the handling of the goods from the quay to another place (warehouse, terminal, transport station, etc.) in or outside the port, the DDU or DDP terms should be used.

A The seller's obligations

B The buyer's obligations

A1 Provision of goods in conformity with the contract

The seller must provide the goods and the commercial invoice, or its equivalent electronic message, in conformity with the contract of sale and any other evidence of conformity which may be required by the contract.

B1 Payment of the price

The buyer must pay the price as provided in the contract of sale.

A2 Licences, authorizations and formalities

The seller must obtain at his own risk and expense any export licence or other official authorization or other documents and carry out, where applicable,[76] all customs formalities necessary for the export of the goods, and for their transit through any country.

B2 Licences, authorizations and formalities

The buyer must obtain at his own risk and expense any import licence or other official authorization or other documents and carry out, where applicable,[77] all customs formalities necessary for the import of the goods.

A3 Contracts of carriage and insurance

(a) Contract of carriage

The seller must contract at his own expense for the carriage of the goods to the named quay (wharf) at the named port of destination. If a specific quay (wharf) is not agreed or is not determined by practice, the seller may select the quay (wharf) at the named port of destination which best suits his purpose.

(b) Contract of insurance

No obligation.[78]

B3 Contracts of carriage and insurance

(a) Contract of carriage

No obligation.[79]

(b) Contract of insurance

No obligation.[80]

A4 Delivery

The seller must place the goods at the disposal of the buyer on the quay (wharf) referred to in A3 *(a)*, on the date or within the agreed period.

B4 Taking delivery

The buyer must take delivery of the goods when they have been delivered in accordance with A4.

A5 Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have been delivered in accordance with A4.

B5 Transfer of risks

The buyer must bear all risks of loss of or damage to the goods from the time they have been delivered in accordance with A4.

The buyer must, should he fail to give notice in accordance with B7, bear all risks of loss of or damage to the goods from the agreed date or the expiry date of the agreed period for delivery provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

A6 Division of costs

The seller must, subject to the provisions of B6, pay

- in addition to costs resulting from A3 *(a)*, all costs relating to the goods until such time as they are delivered on the quay (wharf) in accordance with A4; and
- where applicable,[81] the costs of customs formalities necessary for export as well as all duties, taxes and other charges payable upon export of the goods and for their transit through any country prior to delivery.

B6 Division of costs

The buyer must pay

- all costs relating to the goods from the time they have been delivered in accordance with A4, including any costs of handling the goods in the port for subsequent transport or storage in warehouse or terminal; and all additional costs incurred if he fails to take delivery of the goods when they have been placed at his disposal in accordance with A4, or to give notice in accordance with B7, provided, however, that the goods have been appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods; and
- where applicable,[82] the cost of customs formalities as well as all duties, taxes and other charges payable upon import of the goods and for their subsequent transport.

[75]Ibid., para. 11.

[76]Ibid., para. 14.

[77]Ibid.

[78]Ibid., para. 10.

[79]Ibid.

[80]Ibid., para. 10.

[81]Ibid., para. 14.

[82]Ibid.

A7 Notice to the buyer

The seller must give the buyer sufficient notice of the estimated time of arrival of the nominated vessel in accordance with A4, as well as any other notice required in order to allow the buyer to take measures which are normally necessary to enable him to take delivery of the goods.

B7 Notice to the seller

The buyer must, whenever he is entitled to determine the time within an agreed period and/or the point of taking delivery in the named port of destination, give the seller sufficient notice thereof.

A8 Proof of delivery, transport document or equivalent electronic message

The seller must provide the buyer at the seller's expense with the delivery order and/or the usual transport document (for example a negotiable bill of lading, a non-negotiable sea waybill, an inland waterway document or a multimodal transport document) to enable him to take the goods and remove them from the quay (wharf).

Where the seller and the buyer have agreed to communicate electronically, the document referred to in the preceding paragraph may be replaced by an equivalent electronic data interchange (EDI) message.

B8 Proof of delivery, transport document or equivalent electronic message

The buyer must accept the delivery order or transport document in accordance with A8.

A9 Checking—packaging—marking

The seller must pay the costs of those checking operations (such as checking quality, measuring, weighing, counting) which are necessary for the purpose of delivering the goods in accordance with A4.

The seller must provide at his own expense packaging (unless it is usual for the particular trade to deliver the goods of the contract description unpacked) which is required for the delivery of the goods. Packaging is to be marked appropriately.

B9 Inspection of goods

The buyer must pay the costs of any pre-shipment inspection except when such inspection is mandated by the authorities of the country of export.

A10 Other obligations

The seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages (other than those mentioned in A8) issued or transmitted in the country of dispatch and/or origin which the buyer may require for the import of the goods.

The seller must provide the buyer, upon request, with the necessary information for procuring insurance.

B10 Other obligations

The buyer must pay all costs and charges incurred in obtaining the documents or equivalent electronic messages mentioned in A10 and reimburse those incurred by the seller in rendering his assistance in accordance therewith.

DDU

Delivered duty unpaid (... named place of destination)

"Delivered Duty Unpaid" means that the seller delivers the goods to the buyer, not cleared for import, and not unloaded from any arriving means of transport at the named place of destination. The seller has to bear the costs and risks involved in bringing the goods thereto, other than, where applicable,[83] any "duty" (which term includes the responsibility for and the risks of the carrying out of customs formalities, and the payment of formalities, customs duties, taxes and other charges) for import in the country of destination. Such "duty" has to be borne by the buyer as well as any costs and risks caused by his failure to clear the goods for import in time.

However, if the parties wish the seller to carry out customs formalities and bear the costs and risks resulting therefrom as well as some of the costs payable upon import of the goods, this should be made clear by adding explicit wording to this effect in the contract of sale.[84]

This term may be used irrespective of the mode of transport but when delivery is to take place in the port of destination on board the vessel or on the quay (wharf), the DES or DEQ terms should be used.

A The seller's obligations

B The buyer's obligations

A1 Provision of the goods in conformity with the contract

The seller must provide the goods and the commercial invoice, or its equivalent electronic message, in conformity with the contract of sale and any other evidence of conformity which may be required by the contract.

B1 Payment of the price

The buyer must pay the price as provided in the contract of sale.

A2 Licences, authorizations and formalities

The seller must obtain at his own risk and expense any export licence and other official authorization or other documents and carry out, where applicable,[85] all customs formalities necessary for the export of the goods and for their transit through any country.

B2 Licences, authorizations and formalities

The buyer must obtain at his own risk and expense any import licence or other official authorization or other documents and carry out, where applicable,[86] all customs formalities necessary for the import of the goods.

A3 Contracts of carriage and insurance

(a) Contract of carriage

The seller must contract at his own expense for the carriage of the goods to the named place of destination. If a specific point is not agreed or is not determined by practice, the seller may select the point at the named place of destination which best suits his purpose.

[83]Ibid., para. 14.

[84]Ibid., para. 11.

[85]Ibid., para. 14.

[86]Ibid.

(b) Contract of insurance

No obligation.[87]

B3 Contracts of carriage and insurance

(a) Contract of carriage

No obligation.[88]

(b) Contract of insurance

No obligation.[89]

A4 Delivery

The seller must place the goods at the disposal of the buyer, or at that of another person named by the buyer, on any arriving means of transport not unloaded, at the named place of destination on the date or within the period agreed for delivery.

B4 Taking delivery

The buyer must take delivery of the goods when they have been delivered in accordance with A4.

A5 Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have been delivered in accordance with A4.

B5 Transfer of risks

The buyer must bear all risks of loss of or damage to the goods from the time they have been delivered in accordance with A4.

The buyer must, should he fail to fulfil his obligations in accordance with B2, bear all additional risks of loss of or damage to the goods incurred thereby.

The buyer must, should he fail to give notice in accordance with B7, bear all risks of loss of or damage to the goods from the agreed date or the expiry date of the agreed period for delivery provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

A6 Division of costs

The seller must, subject to the provisions of B6, pay

- in addition to costs resulting from A3 *(a)*, all costs relating to the goods until such time as they have been delivered in accordance with A4; and
- where applicable,[90] the costs of customs formalities necessary for export as well as all duties, taxes and other charges payable upon export and for their transit through any country prior to delivery in accordance with A4.

B6 Division of costs

The buyer must pay

- all costs relating to the goods from the time they have been delivered in accordance with A4; and
- all additional costs incurred if he fails to fulfil his obligations in accordance with B2, or to give notice in accordance with B7, provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods; and
- where applicable,[91] the costs of customs formalities as well as all duties, taxes and other charges payable upon import of the goods.

A7 Notice to the buyer

The seller must give the buyer sufficient notice of the dispatch of the goods as well as any other notice required in order to allow the buyer to take measures which are normally necessary to enable him to take delivery of the goods.

B7 Notice to the seller

The buyer must, whenever he is entitled to determine the time within an agreed period and/or the point of taking delivery at the named place, give the seller sufficient notice thereof.

A8 Proof of delivery, transport document or equivalent electronic message

The seller must provide the buyer at the seller's expense the delivery order and/or the usual transport document (for example a negotiable bill of lading, a non-negotiable sea waybill, an inland waterway document, an air waybill, a railway consignment note, a road consignment note, or a multimodal transport document) which the buyer may require to take delivery of the goods in accordance with A4/B4.

Where the seller and the buyer have agreed to communicate electronically, the document referred to in the preceding paragraph may be replaced by an equivalent electronic data interchange (EDI) message.

B8 Proof of delivery, transport document or equivalent electronic message

The buyer must accept the appropriate delivery order or transport document in accordance with A8.

A9 Checking—packaging—marking

The seller must pay the costs of those checking operations (such as checking quality, measuring, weighing, counting) which are necessary for the purpose of delivering the goods in accordance with A4.

The seller must provide at his own expense packaging (unless it is usual for the particular trade to deliver the goods of the contract description unpacked) which is required for the delivery of the goods. Packaging is to be marked appropriately.

B9 Inspection of goods

The buyer must pay the costs of any pre-shipment inspection except when such inspection is mandated by the authorities of the country of export.

A10 Other obligations

The seller must render the buyer at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages (other than those mentioned in A8) issued or transmitted in the country of dispatch and/or of origin which the buyer may require for the import of the goods.

The seller must provide the buyer, upon request, with the necessary information for procuring insurance.

[87]Ibid., para. 10.

[88]Ibid.

[89]Ibid.

[90]Ibid., para. 14.

[91]Ibid.

B10 Other obligations

The buyer must pay all costs and charges incurred in obtaining the documents or equivalent electronic messages mentioned in A10 and reimburse those incurred by the seller in rendering his assistance in accordance therewith.

DDP

Delivered duty paid (... named place of destination)

"Delivered Duty Paid" means that the seller delivers the goods to the buyer, cleared for import, and not unloaded from any arriving means of transport at the named place of destination. The seller has to bear all the costs and risks involved in bringing the goods thereto including, where applicable,[92] any "duty" (which term includes the responsibility for and the risks of the carrying out of customs formalities and the payment of formalities, customs duties, taxes and other charges) for import in the country of destination.

Whilst the EXW term represents the minimum obligation for the seller, DDP represents the maximum obligation.

This term should not be used if the seller is unable directly or indirectly to obtain the import licence.

However, if the parties wish to exclude from the seller's obligations some of the costs payable upon import of the goods (such as value-added tax: VAT), this should be made clear by adding explicit wording to this effect in the contract of sale.[93]

If the parties wish the buyer to bear all risks and costs of the import, the DDU term should be used.

This term may be used irrespective of the mode of transport but when delivery is to take place in the port of destination on board the vessel or on the quay (wharf), the DES or DEQ terms should be used.

A The seller's obligations

B The buyer's obligations

A1 Provision of the goods in conformity with the contract

The seller must provide the goods and the commercial invoice, or its equivalent electronic message, in conformity with the contract of sale and any other evidence of conformity which may be required by the contract.

B1 Payment of the price

The buyer must pay the price as provided in the contract of sale.

A2 Licences, authorizations and formalities

The seller must obtain at his own risk and expense any export and import licence and other official authorization or other documents and carry out, where applicable,[94] all customs formalities necessary for the export of the goods, for their transit through any country and for their import.

B2 Licences, authorizations and formalities

The buyer must render the seller at the latter's request, risk and expense, every assistance in obtaining, where applicable,[95] any import licence or other official authorization necessary for the import of the goods.

A3 Contracts of carriage and insurance

(a) Contract of carriage

The seller must contract at his own expense for the carriage of the goods to the named place of destination. If a specific point is not agreed or is not determined by practice, the seller may select the point at the named place of destination which best suits his purpose.

(b) Contract of insurance

No obligation.[96]

B3 Contracts of carriage and insurance

(a) Contract of carriage

No obligation.[97]

(b) Contract of insurance

No obligation.[98]

A4 Delivery

The seller must place the goods at the disposal of the buyer, or at that of another person named by the buyer, on any arriving means of transport not unloaded at the named place of destination on the date or within the period agreed for delivery.

B4 Taking delivery

The buyer must take delivery of the goods when they have been delivered in accordance with A4.

A5 Transfer of risks

The seller must, subject to the provisions of B5, bear all risks of loss of or damage to the goods until such time as they have been delivered in accordance with A4.

B5 Transfer of risks

The buyer must bear all risks of loss of or damage to the goods from the time they have been delivered in accordance with A4.

The buyer must, should he fail to fulfil his obligations in accordance with B2, bear all additional risks of loss of or damage to the goods incurred thereby.

The buyer must, should he fail to give notice in accordance with B7, bear all risks of loss of or damage to the goods from the agreed date or the expiry date of the agreed period for delivery provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

A6 Division of costs

The seller must, subject to the provisions of B6, pay

- in addition to costs resulting from A3 *(a)*, all costs relating to the goods until such time as they have been delivered in accordance with A4; and

[92]Ibid., para. 14.

[93]Ibid., para. 11.

[94]Ibid., para. 14.

[95]Ibid., para. 14.

[96]Ibid., para. 10.

[97]Ibid.

[98]Ibid.

- where applicable,[99] the costs of customs formalities necessary for export and import as well as all duties, taxes and other charges payable upon export and import of the goods, and for their transit through any country prior to delivery in accordance with A4.

B6 Division of costs

The buyer must pay

- all costs relating to the goods from the time they have been delivered in accordance with A4; and
- all additional costs incurred if he fails to fulfil his obligations in accordance with B2, or to give notice in accordance with B7, provided, however, that the goods have been duly appropriated to the contract, that is to say, clearly set aside or otherwise identified as the contract goods.

A7 Notice to the buyer

The seller must give the buyer sufficient notice of the dispatch of the goods as well as any other notice required in order to allow the buyer to take measures which are normally necessary to enable him to take delivery of the goods.

B7 Notice to the seller

The buyer must, whenever he is entitled to determine the time within an agreed period and/or the point of taking delivery at the named place, give the seller sufficient notice thereof.

A8 Proof of delivery, transport document or equivalent electronic message

The seller must provide the buyer at the seller's expense with the delivery order and/or the usual transport document (for example a negotiable bill of lading, a non-negotiable sea waybill, an inland waterway document, an air waybill, a railway consignment note, a road consignment note, or a multimodal transport document) which the buyer may require to take delivery of the goods in accordance with A4/B4.

[99]Ibid., para. 14.

Where the seller and the buyer have agreed to communicate electronically, the document referred to in the preceding paragraph may be replaced by an equivalent electronic data interchange (EDI) message.

B8 Proof of delivery, transport document or equivalent electronic message

The buyer must accept the appropriate delivery order or transport document in accordance with A8.

A9 Checking—packaging—marking

The seller must pay the costs of those checking operations (such as checking quality, measuring, weighing, counting) which are necessary for the purpose of delivering the goods in accordance with A4.

The seller must provide at his own expense packaging (unless it is usual for the particular trade to deliver the goods of the contract description unpacked) which is required for the delivery of the goods. Packaging is to be marked appropriately.

B9 Inspection of goods

The buyer must pay the costs of any pre-shipment inspection except when such inspection is mandated by the authorities of the country of export.

A10 Other obligations

The seller must pay all costs and charges incurred in obtaining the documents or equivalent electronic messages mentioned in B10 and reimburse those incurred by the buyer in rendering his assistance herewith.

The seller must provide the buyer, upon request, with the necessary information for procuring insurance.

B10 Other obligations

The buyer must render the seller, at the latter's request, risk and expense, every assistance in obtaining any documents or equivalent electronic messages issued or transmitted in the country of import which the seller may require for the purpose of making the goods available to the buyer in accordance therewith.

VII. CASE LAW ON UNCITRAL TEXTS (CLOUT)

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. A/CN.9/SER.C/ABSTRACTS 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@uncitral.org

3. They may also be accessed through the UNCITRAL home page on the worldwide web (*http:/www.uncitral.org*)

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.

VIII. STATUS OF UNCITRAL TEXTS

Status of Conventions and Model Law: note by the secretariat (A/CN.9/474) [Original: English]

Not reproduced. The updated list may be obtained from the UNCITRAL secretariat or found on the Internet home page (*http://www.uncitral.org*).

IX. TRAINING AND ASSISTANCE

Training and technical assistance: note by the secretariat (A/CN.9/473) [Original: English]

CONTENTS

I. INTRODUCTION

1. Pursuant to a decision taken at the twentieth session of the United Nations Commission on International Trade Law (UNCITRAL),[1] held in 1987, training and assistance activities count among the high priorities of UNCITRAL. The training and technical assistance programme carried out by the secretariat under the mandate given by the Commission, in particular in developing countries and in countries with economies in transition, encompasses two main lines of activity: *(a)* information activities aimed at promoting understanding of international commercial law conventions, model laws and other legal texts; and *(b)* assistance to Member States with commercial law reform and adoption of UNCITRAL texts.

2. The present note lists the activities of the secretariat subsequent to the issuance of the previous note submitted to the Commission at its thirty-second session, in 1999 (A/CN.9/461), and indicates possible future training and technical assistance activities in the light of the requests for such services from the secretariat.

II. IMPORTANCE OF TEXTS OF THE UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW

3. In an era of globalization, increasing importance is 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 that process because it has produced and promotes the use of legal instruments in a number of key areas of commercial law that represent internationally agreed standards and solutions acceptable to different legal systems. Those instruments include:

(*a*) In the area of sales, the United Nations Convention on Contracts for the International Sale of Goods[2] and the United Nations Convention on the Limitation Period in the International Sale of Goods;[3]

[1] *Official Records of the General Assembly, Forty-second Session, Supplement No. 17* (A/42/17), para. 335.

[2] *Official Records of the United Nations Conference on Contracts for the International Sale of Goods, Vienna, 10 March-11 April 1980* (United Nations publication, Sales No. E.82.V.5), part I).

[3] *Official Records of the United Nations Conference on Prescription (Limitation) in the International Sale of Goods, New York, 20 May-14 June 1974* (United Nations publication, Sales No. E.74.V.8), part I).

(b) In the area of dispute resolution, the Convention on the Recognition and Enforcement of Foreign Arbitral Awards[4] (a United Nations convention adopted prior to the establishment of the Commission, but actively promoted by it), the UNCITRAL Arbitration Rules,[5] the UNCITRAL Conciliation Rules,[6] the UNCITRAL Model Law on International Commercial Arbitration[7] and the UNCITRAL Notes on Organizing Arbitral Proceedings;[8]

(c) In the area of procurement, the UNCITRAL Model Law on Procurement of Goods, Construction and Services;[9]

(d) In the area of banking, payments and insolvency, the United Nations Convention on Independent Guarantees and Standby Letters of Credit (General Assembly resolution 50/48, annex), the UNCITRAL Model Law on International Credit Transfers,[10] the United Nations Convention on International Bills of Exchange and International Promissory Notes (General Assembly resolution 43/165, annex) and the UNCITRAL Model Law on Cross-Border Insolvency;[11]

(e) In the area of transport, the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules),[12] and the United Nations Convention on the Liability of Operators of Transport Terminals in International Trade;[13]

(f) In the area of electronic commerce and data interchange, the UNCITRAL Model Law on Electronic Commerce.[14]

4. Harmonization and unification of the law of international trade maximizes the ability of business parties from different States to successfully plan and implement commercial transactions and, thus, fosters investors' confidence. In its resolution 54/103 of 9 December 1999, the General Assembly reaffirmed 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 contribute significantly to universal economic cooperation among all States on a basis of equality, equity and common interest and to the elimination of discrimination in international trade and, thereby, to the well-being of all peoples. The growing interest in commercial law reform represents a crucial opportunity for UNCITRAL to further those objectives significantly, as envisaged by the Assembly in its resolution 2205 (XXI) of 17 December 1966.

[4]United Nations, *Treaty Series*, vol. 330, No. 4739.

[5]*Official Records of the General Assembly, Thirty-first Session, Supplement No. 17* (A/31/17), para. 57.

[6]Ibid., *Thirty-fifth Session, Supplement No. 17* (A/35/17), para. 106.

[7]Ibid., *Fortieth Session, Supplement No. 17* (A/40/17), annex I.

[8]Ibid., *Fifty-first Session, Supplement No. 17* (A/51/17), chap. II.

[9]Ibid., *Forty-ninth Session, Supplement No. 17* and corrigendum (A/49/17 and Corr.1), annex I.

[10]Ibid., *Forty-seventh Session, Supplement No. 17* (A/47/17), annex I.

[11]Ibid., *Fifty-second Session, Supplement No. 17* (A/52/17), annex I.

[12]*Official Records of the United Nations Conference on the Carriage of Goods by Sea, Hamburg, 6-31 March 1978* (United Nations publication, Sales No. E.80.VIII.1), document A/CONF.89/13, annex I.

[13]A/CONF.152/13, annex.

[14]Ibid., *Fifty-first Session, Supplement No. 17* (A/51/17), annex I.

III. TECHNICAL ASSISTANCE TO THE PREPARATION AND IMPLEMENTATION OF LEGISLATION

5. Technical assistance is provided to States preparing legislation based on UNCITRAL texts. Such assistance is provided in various forms, including review of preparatory drafts of legislation from the viewpoint of UNCITRAL texts, technical consultancy services and assistance in the preparation of legislation based on UNCITRAL texts, preparation of regulations implementing such legislation and comments on reports of law reform commissions, as well as briefings for legislators, judges, arbitrators, procurement officials and other users of UNCITRAL texts embodied in national legislation. Another form of technical assistance provided by the secretariat consists of advising on the establishment of institutional arrangements for international commercial arbitration, including training seminars for arbitrators, judges and practitioners in the area.

6. In its resolution 54/103, the General Assembly reaffirmed the importance, in particular for developing countries, of the work of the Commission concerned with training and technical assistance in the field of international trade law, such as assistance in the preparation of national legislation based on legal texts of the Commission, while expressing its concern 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; and appealed to the United Nations Development Programme and other bodies responsible for development assistance, such as the International Bank for Reconstruction and Development and the European Bank for Reconstruction and Development (EBRD), 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.

7. The secretariat of the Commission has taken steps to increase cooperation and coordination with development assistance agencies, with a view to ensuring that the legal texts prepared by the Commission and recommended by the General Assembly for consideration are in fact so considered and used. From the standpoint of recipient States, UNCITRAL technical assistance is beneficial because of the secretariat's accumulated experience in the preparation of UNCITRAL texts.

8. States that are in the process of revising their trade legislation may wish to request the UNCITRAL secretariat to provide technical assistance and advice.

IV. SEMINARS AND BRIEFING MISSIONS

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, for example, Uniform Customs and Practice for Documentary Credits and Incoterms of the International Chamber of Commerce and the Convention on International Factoring of the International Institute for the Unification of Private Law (Unidroit).

10. In resolution 54/103, the General Assembly expressed the desirability for increased efforts by the Commission, in sponsoring seminars and symposia, to provide training and technical assistance.

11. Lectures at UNCITRAL seminars are generally conducted by one or two members of the UNCITRAL secretariat, experts from the host countries and, occasionally, external consultants. After the seminars, the 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 texts.

12. Since the previous session, the secretariat of the Commission has organized seminars in a number of States, which have typically included briefing missions. The following seminars were financed with resources from the UNCITRAL trust fund for symposia:

(a) Johannesburg, South Africa (6 and 7 May 1999), seminar held in cooperation with the Ministry of Foreign Affairs and the University of Stellenbosch (approx. 50 participants);

(b) Stellenbosch, South Africa (9 and 10 May 1999), seminar held in cooperation with the Ministry of Foreign Affairs and the University of Stellenbosch (approx. 50 participants);

(c) Pretoria (11 and 12 May 1999), seminar held in cooperation with the Ministry of Foreign Affairs and the University of Stellenbosch (approx. 30 participants);

(d) Yaoundé (10-12 May 1999), seminar held in cooperation with the Government of Cameroon and the African Development Bank (AFDB) (approx. 200 participants);

(e) Abidjan (13 and 14 May 1999), seminar held in cooperation with the Government of Cameroon and AFDB (approx. 30 participants);

(f) Rio de Janeiro, Brazil (12 and 13 August 1999), seminar held in cooperation with the Ministry of External Relations (approx. 100 participants);

(g) Lima (19 and 20 August 1999), seminar held in cooperation with the Iberoamerican Institute for International Economic Law (approx. 60 participants);

(h) Cuzco, Peru (23-25 August 1999), seminar held in cooperation with the Iberoamerican Institute for International Economic Law (approx. 50 participants);

(i) Brasilia (30 and 31 August 1999), seminar held in cooperation with the Ministry of External Relations (approx. 140 participants);

(j) São Paulo, Brazil (2 and 3 September 1999), seminar held in cooperation with the Ministry of External Relations (approx. 150 participants);

(k) Moscow (2-4 November 1999), seminar held in cooperation with the Chamber of Commerce and Industry of the Russian Federation (approx. 60 participants);

(l) Antananarivo (6-8 March 2000), seminar held in cooperation with the Ministry of Consumers and Trade (approx. 40 participants).

V. PARTICIPATION IN OTHER ACTIVITIES

13. Members of the UNCITRAL secretariat have participated as speakers in various seminars, conferences and courses where UNCITRAL texts were presented for examination and possible adoption or use. The participation of members of the secretariat in the seminars, conferences and courses listed below was financed by the institution organizing the events or by another organization:

(a) Dickinson Law School Summer Programme (Florence, Italy, 18 June 1999);

(b) Tenth Annual Workshop and Symposium on Arbitration of the Institute for Transnational Arbitration (Dallas, Texas, United States of America, 17 June 1999);

(c) Global Financial Services Conference, sponsored by the Commercial Finance Association and the Factors and Discounters Association (London, 9-11 June 1999);

(d) Tenth International Summer Academy, sponsored by Logistik und Transport-Consult (Sopron, Hungary, 23 and 24 June 1999);

(e) Round Table on Questions of Private International Law Raised by Electronic Commerce and the Internet, sponsored by the Hague Conference on Private International Law and the University of Geneva (Geneva, Switzerland, 2-4 September 1999);

(f) Symposium on Insolvency Reform: Building Effective Systems, sponsored by the World Bank (Washington, D.C., 14 and 15 September 1999);

(g) Colloquium on Technology and Law, sponsored by the University of Heidelberg (Heidelberg, Germany, 23 and 24 September 1999);

(h) Arbitration Seminar, sponsored by the World Intellectual Property Organization (WIPO) (Warsaw, 17 September 1999);

(i) Conference on Electronic Commerce and Intellectual Property, sponsored by WIPO (Geneva, Switzerland, 14-16 September 1999);

(j) Symposium on Insolvency Law Reforms, sponsored by the Asian Development Bank (Manila, 25-27 October 1999);

(k) Conference on Disputes in International Financial Transactions, sponsored by the Foundation of the National and International Arbitration Court of Venice (Venice, Italy, 22 and 23 October 1999);

(l) Regional Seminar on Electronic Commerce for African Countries, sponsored by the United Nations Conference on Trade and Development (UNCTAD) and the Ministry of Trade of Kenya (Nairobi, 7 and 8 October 1999);

(m) International Arbitration Seminar of the Arbitration Tribunal of the International Chamber of Commerce, sponsored by the German Foundation for International Legal Cooperation (Kiev, 25-27 October 1999);

(n) Annual Congress of Union Internationale des Avocats (Delhi, 3-6 November 1999);

(*o)* World E-Com Conference, sponsored by the West Australian Department of Commerce and Trade (Perth, Australia, 8-10 November 1999);

(*p)* Infrastructure Conference of the Asia-Pacific Forum of the International Bar Association (Manila, 10-13 November 1999);

(q) Conference on Public Private Partnership—The Legal Framework for Privatization of Infrastructure Projects in Central and Eastern Europe, sponsored by the International Association of Young Lawyers (Warsaw, 18-20 November 1999);

(r) Conference on Insolvency Regimes in Asia: A Comparative Perspective, sponsored by the Organisation for Economic Cooperation and Development (OECD), the World Bank, the Asian Development Bank and the Australian Treasury (Sydney, Australia, 29 and 30 November 1999);

(s) Conference on Internet and Electronic Commerce, sponsored by the Ministry of Telecommunication and the Tunisian Internet Agency (Tunis, 9 and 10 November 1999);

(t) Chartered Institute of Arbitrators/Cairo Regional Centre for International Commercial Arbitration: Entry, Special Fellowship and Award Writing Courses (Cairo, 28 November-3 December 1999);

(*u)* Pan-African Arbitration Congress of the London Court of International Arbitration (Cairo, 4 December 1999);

(v) International Bar Association Conference on Uniform Commercial Laws, Infrastructure and Project Finance in Africa (Yaoundé, 9-11 December 1999);

(w) Fifth Legal Colloquium, sponsored by the European Central Bank (Frankfurt, Germany, 13 December 1999);

(*x)* Lectures on electronic commerce at the University of Bologna (Bologna, Italy, 21 and 22 December 1999);

(y) Arbitrators' Training Course, sponsored by the Arbitration Centre at Ein Shams University (Cairo, 24-28 January 2000);

(*z)* 2000 Global Internet Summit, sponsored by the George Mason University (Washington, D.C., 12-14 March 2000);

(aa) Lecture on the United Nations Convention on Independent Guarantees and Standby Letters of Credit, held at Cabinet Coudert Frères (Paris, 2 March 2000);

(bb) Symposium on International Commercial Arbitration in the Asia-Oceania Region, sponsored by the Institute for Socio-Economic Dispute Studies, Meijo University Graduate School of Law (Nagoya, Japan, 22 and 23 February 2000);

(cc) Alternative Dispute Resolution Workshop, sponsored by the Japan Commercial Arbitration Association (Nagoya, Japan, 24 February 2000);

(dd) Offshore E-Commerce Meeting, sponsored by IBC USA Conferences Inc. (Miami, Florida, United States of America, 22 February 2000);

(ee) International Conference on Electronic Commerce, Multilateral Rules and Impacts on Development, sponsored by the Commonwealth secretariat and the Ministry of International Trade and Industry in Malaysia (Kuala Lumpur, 13-15 March 2000);

(ff) Lectures on electronic commerce at the University of Lecce (Lecce, Italy, 31 March 2000);

(gg) Conference on Arbitration and Conciliation as Methods of Settlement of Disputes and Alternatives to State Justice, sponsored by the University of Valencia, the Valencia Bar Association and the Chamber of Commerce (Valencia, Spain, 6 and 7 April 2000);

(hh) Annual Meeting of the Swiss Association of Communication Law (Zurich, Switzerland, 7 April 2000);

(ii) 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, 26 April 2000);

(jj) EE Business Information Center Electronic Commerce Conference (Dubai, 26 April 2000).

14. The participation of members of the secretariat in the seminars, conferences and courses listed below was financed with resources from the United Nations regular travel budget:

(a) International Federation of Insolvency Professionals (INSOL International) 1999 Regional Conference (Hamilton, 28-30 April 1999);

(b) Spring meeting of the Section on International Law and Practice of the American Bar Association (Hamilton, 1-3 May 1999);

(c) Commonwealth Law Ministers Meeting (Port-of-Spain, 5-7 May 1999);

(d) Twelfth Bled Electronic Commerce Conference, sponsored by the University of Maribor (Bled, Slovenia, 7-9 June 1999);

(*e)* Fourth Meeting of the Committee of Experts on Electronic Commerce of the Free Trade Area of the Americas of the Organization of American States (Miami, Florida, United States of America, 14-16 June 1999);

(f) International Bar Association Seminar on Insolvency and Fraud—Insolvency and Suggestions for Legislative Improvement (Copenhagen, 13-15 June 1999);

(g) UNCTAD Expert Group Meeting on Electronic Commerce (Geneva, Switzerland, 14-16 July 1999);

(h) Annual Conference of the International Bar Association (Barcelona, Spain, 26 September- 2 October 1999);

(*i)* UNCITRAL/INSOL International Judicial Colloquium and the European Insolvency Practitioners Association/INSOL International Joint Congress (Munich, Germany, 13-17 October 1999);

(*j)* Chartered Institute of Arbitrators Millennium Conference (London, 18 and 19 November 1999);

(k) Forum on Electronic Commerce, sponsored by OECD (Paris, 12 and 13 October 1999);

(l) INSOL International Conference on Insolvency Law (Delhi, 26 February 2000);

(m) South Asian Association for Regional Cooperation Law Conference sponsored by the Federation of Indian Chambers of Commerce and Industry (Delhi, 1 March 2000);

(n) International Council for Commercial Arbitration Conference 2000 (Delhi, 2-4 March 2000);

(o) Arbitration Seminar, sponsored by the Federation of Nepalese Chambers of Commerce and Industry (Kathmandu, 7 and 8 March 2000);

(*p)* Central Europe and Baltic States Regional Insolvency Workshop, sponsored by EBRD and the World Bank (Bratislava, 14 and 15 March 2000).

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 nine interns from Australia, Germany, Poland, Spain and the United States. 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 or government agency or they meet their expenses from their own means. In this connection, the Commission may wish to invite Member States, universities and other organizations, in addition to those which already do so, to consider sponsoring the participation of young lawyers in 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 2000, seminars and legal assistance briefing missions are being planned in central and eastern Asia, the Caribbean and the Middle East. Since the cost of training and technical assistance activities is not covered by the regular budget, the ability of the secretariat to implement those plans is contingent upon the receipt of sufficient funds in the form of contributions to the UNCITRAL trust fund for symposia.

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 ILO in Turin. Typically, approximately half the participants are from Italy, with many of the remainder coming from developing countries. The contribution from the UNCITRAL secretariat to the next course will focus on issues of harmonization of laws on international trade law from the perspective of UNCITRAL, including past and current work.

VIII. FINANCIAL RESOURCES

19. The secretariat continues its efforts to devise a more extensive training and technical assistance programme to meet the considerably greater demand from States for training and assistance, in keeping with the call of the Commission at its twentieth session for an increased emphasis both on training and assistance and on the promotion of the legal texts prepared by the Commission. However, as no funds for UNCITRAL seminars are provided for in the regular budget, expenses for UNCITRAL training and technical assistance activities (except for those which are supported by funding agencies such as the World Bank) have to be met from voluntary contributions to the UNCITRAL trust fund for symposia.

20. Given the importance of extrabudgetary funding for the implementation of the training and technical assistance component of the UNCITRAL work programme, the Commission may again wish to appeal to all States, international organizations and other interested entities to consider making contributions to the UNCITRAL trust fund for symposia, in particular in the form of multi-year contributions, so as to facilitate planning and to enable the secretariat to meet the increasing demands from developing countries and States with economies in transition for training and assistance. Information on how to make contributions may be obtained from the secretariat.

21. In the period under review, contributions were received from Canada, Cyprus, Greece, Mexico and the United Kingdom. The Commission may wish to express its appreciation to those States and organizations which have contributed to the Commission's programme of training and assistance by providing funds or staff or by hosting seminars.

22. In that connection, the Commission may wish to recall that, in accordance with General Assembly resolution 48/32 of 9 December 1993, the Secretary-General was requested to establish a trust fund to grant travel assistance to developing countries that are members of UNCITRAL. The trust fund so established is open to voluntary financial contributions from States, intergovernmental organizations, regional economic integration organizations, national institutions and non-governmental organizations, as well as to natural and juridical persons.

23. At its thirty-first session, the Commission noted with appreciation that the General Assembly, in its resolution 52/157 of 15 December 1997, had appealed to Governments, the relevant United Nations organs, organizations, institutions and individuals, in order to ensure full participation by all Member States in the sessions of the Commission and its working groups, to make voluntary contributions to the trust fund for granting travel assistance to developing countries that are members of the Commission,

at their request and in consultation with the Secretary-General.

24. Since the establishment of the trust fund, contributions have been received from Cambodia, Kenya and Singapore.

25. It is recalled that in its resolution 51/161 of 16 December 1996, the General Assembly decided to include the trust funds for symposia and travel assistance in the list of funds and programmes that are dealt with at the United Nations Pledging Conference for Development Activities.

Part Three

ANNEXES

I. UNCITRAL LEGISLATIVE GUIDE ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS

[Reproduced as a book under the symbol A/CN.9/SER.B/4]

II. SUMMARY RECORDS OF THE UNITED NATIONS COMMISSION ON INTERNATIONAL TRADE LAW FOR MEETINGS DEVOTED TO THE PREPARATION OF THE DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES

Summary record (partial)* of the 676th Meeting

Monday, 12 June 2000, at 10 a.m.

[A/CN.9/SR.676]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.45 a.m.

The discussion covered in the summary record began at 11.30 a.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES (A/CN.9/466, 470, 472 and Add.1-4)

1. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the Group's report on the work of its thirty-first session was contained in document A/CN.9/466; the text of the draft Convention as adopted by the Working Group was annexed to the report. As requested by the Commission, the secretariat had prepared an analytical commentary on the draft Convention, which could be found in document A/CN.9/470. The text used for the commentary was the text adopted by the Working Group, with minor editorial changes. As requested by the Working Group, the secretariat had circulated the text of the draft Convention to Governments and international organizations; the comments received had been issued in documents A/CN.9/472 and Add.1-4.

2. The Commission might wish to begin by considering issues which had been identified by the Working Group as the most important pending issues. It could first address the issue of the scope of application, in particular the question of assignment of receivables other than trade receivables. Another very important issue was the definition of the term "location", which was defined in article 6, subparagraph (i), and would need to be considered also in connection with articles 24 to 27. Once the Commission had addressed those issues, it could take up the articles of the draft Convention in numerical order. The Commission would need to decide whether the final adoption of the draft Convention should take place in the General Assembly or at a diplomatic conference.

3. The CHAIRMAN said that it was implicit in the suggestion by the secretariat that the Commission would defer consideration of the title and preamble of the draft Convention until after it had considered the substantive articles.

4. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the Working Group had focused on receivables arising from the sale of goods or the provision of services (trade receivables). It had become clear that a number of other types of receivable could appropriately be included in the scope of the draft Convention, including consumer receivables arising from transactions for personal, family or household purposes, receivables owed by consumers, and receivables arising from a variety of financial transactions including swaps, derivatives, payment and security settlement systems, letters of credit, deposit accounts, and so forth. The Working Group had felt, however, that those other types of receivables would need special treatment: either certain issues addressed in the draft Convention should be addressed in a different way, or the assignment of such receivables should be excluded altogether on the grounds that they were subject to sufficient regulation and might not need additional regulation in the draft Convention.

5. The result of the Working Group's deliberations was reflected in the two variants of article 5 of the draft Convention. Variant A reflected a narrow exclusion, and variant B a broader exclusion. Under variant A, the assignment would still remain valid as between the assignor and the assignee, but its effects as against the debtor would be left to the law applicable outside the draft Convention; under variant B, the validity of an assignment would be left altogether to the law applicable outside the draft Convention. A further difference between the two variants was the inclusion of paragraph 2 in variant A; the reason was that, once the debtor was protected, under paragraph 1, he would not need to have the right to terminate the original contract.

6. The comments made by industry representatives, reproduced in document A/CN.9/472 and Add.1-4, included a third suggestion which was an amended version of variant B. Under that amendment, unless the debtor consented, articles 11 and 12 would apply only to assignments of trade receivables. If articles 11 and 12 did not apply, the validity of the assignment would be left to be determined by applicable law; if it was determined to be invalid, the rest of the draft Convention would not apply.

7. The draft Convention did not address, and could not address, the form of the underlying contract: whether it needed to be in

*No summary record was provided for the first part of the meeting.

writing, and whether an assignment clause that was an oral agreement would need to be honoured in the same way as any other oral agreement between participants in financial arrangements under current law.

8. In the communications received by the secretariat, reference had been made to other types of receivable, such as deposit accounts, which might need to be treated in the same way.

9. Mr. MORÁN BOVIO (Spain) said that his delegation's chief difficulty with variant B was the reference to the rules of private international law, which might be an obstacle in determining the applicable regime. With the addition proposed by the European Banking Federation and reproduced in document A/CN.9/472/Add.1, variant B was very similar to variant A; however, variant A had the advantage of being fuller and clearer, and was therefore preferable.

10. Mr. FERRARI (Italy) said that, if the Commission opted for variant B, it would have to retain the reference to the rules of private international law.

11. Mr. DUCAROIR (Observer for the European Banking Federation) noted that the proposal made by the European Banking Federation (EBF) and other international organizations was a global proposal from the banking and financial industry. In response to the comment by the Spanish delegation, he noted that the words "in conformity with the law applicable by virtue of the rules of private international law" had not been suggested by EBF but had been part of the initial text proposed by the Canadian delegation.

12. The banking and financial industry had at first requested the exclusion of financial receivables from the scope of the Convention, but the Working Group had not shared that opinion and had not wished to narrow the scope of the Convention. Noting that decision of principle, which seemed irrevocable, the banking and financial industry wished for a particular regime to be applied to those receivables, within the Convention, in view of the constraints described in the comments from EBF, as well as in the comments of the International Swaps and Derivatives Association (ISDA) and the Financial Markets Lawyers Group.

13. Variant A was interesting, but introduced an element of uncertainty. Given the existence of different legal regimes, particularly in European countries, it was difficult to see how an assignment could be valid as between the assignor and the assignee, when there were no effects against the debtor. The Federation therefore preferred variant B, which provided for the exclusion of financial receivables, referred to in the document as receivables other than trade receivables, from the application of articles 11 and 12 of the Convention. Variant B also proposed their exclusion from chapter IV, section II, but that seemed unnecessary: if articles 11 and 12 did not apply, there was no reason to be concerned about chapter IV, section II. However, in its present form, the text went too far. Rather than revising variant B, he hoped that it would be possible to review article 6 to amend the definition of "trade receivable" and to add three further definitions, as set out in document A/CN.9/472/Add.1.

14. Mr. BURMAN (United States of America) said that the issue of scope was perhaps the most significant issue relating to the draft Convention. Having conferred with many industry and financial groups in his country, his delegation's general conclusion had been that the draft Convention rules had the greatest impact and worked very well when the receivable related to the sale or lease of goods or another kind of trade or commercial receivable. However, in the case of financial receivables, the Convention rules did not work so well, because transactions relating to financial receivables often took place under industry rules, and any assignments of those receivables were specially structured among sophisticated players. His delegation therefore supported the approach advocated by EBF, which was to formulate a definition to cover those receivables to which all the rules should apply, namely the trade receivables that were the core area where the draft Convention would have its greatest impact, and then to focus on articles 11 and 12. It could be that, within those core receivables, some consideration should be given to cases where there was an anti-assignment clause, but in other cases articles 11 and 12 worked very well. The most likely candidate for exclusion from articles 11 and 12 would be a receivable arising from a loan of money.

15. His delegation had changed its position because it had listened to the comments of other delegations, and of the industry, and had also learned of some fairly sophisticated problems that could arise if some financial receivables were included within the rules of the draft Convention. It was prepared to discuss those problems at the appropriate time, and could also make a specific proposal in writing. However, its overall conclusion was that the definition of receivables should be narrowed, and that some specific exclusions might be necessary.

16. Mr. MEENA (India) said the draft Convention provided that instructions in respect of receivables should not change the currency of payment specified in the original contract, or change the State in which the payment was to be made, to a State other than that in which the debtor was located. Thus it seemed to be in conformity with the exchange control regulations. However, the draft Convention was not applicable to the financing of domestic receivables. Therefore its provisions needed to be examined with regard to action-control regulations. Assets based on securities which generally lacked volatility would acquire the desired mobility by trade in international receivables in the manner suggested in the draft Convention. Such a convention was long overdue and, in the context of the expansion of international trade, would have a significant and effective role to play in the assignment of receivables on an international basis. It would be an appropriate and effective instrument for achieving progress towards a new formula in that area. It would improve assignability and enhance international trade and finance by making credit available at lower cost.

17. His delegation therefore supported the draft Convention currently under discussion. However, the rules of assignment of receivables had social and political ramifications, which deserved serious consideration.

18. With those preliminary observations, and without prejudice to its right to offer detailed comments, his delegation hoped that the draft Convention would be acceptable to all concerned. With regard to the limitations on receivables other than trade receivables under article 5, India supported variant B.

19. Mr. WHITELEY (United Kingdom) supported the modified version of variant B proposed by EBF. He agreed with the Italian delegation that it was difficult to avoid reference to the rules of private international law in terms of determining certain issues under article 5, and in fact paragraph 53 of the analytical commentary indicated that under variant A it would still be necessary to refer to laws applicable outside the Convention. The United Kingdom was concerned that those laws might themselves have an adverse effect on the debtor's interest if the assignment was recognized as between the assignor and the assignee. In such cases, as far as the laws of the United Kingdom were concerned, the debtor would lose many of the protections to which it would otherwise be entitled.

20. Mr. STOUFFLET (France) said that, in its consideration of articles 1 to 5 on scope, the Commission had naturally come to

focus on the problem of financial receivables. However, some other important issues remained open. In regard to the scope of application of the future Convention, the French Government and others had drawn attention in their comments to the case of non-contractual receivables and he would revert to that issue at a later stage.

21. With regard to financial receivables, his delegation preferred variant B, mainly because it allowed the broadest possible scope of application for the draft Convention. In that context, the French delegation also supported the suggestion from EBF which highlighted the true raison d'être of variant B, namely protecting mechanisms for collective-type settlements. Emphasizing the reason underlying the exception was a major merit of the proposal. The specific wording might require further consideration, but the concept fully met the concerns of his delegation.

22. Mr. RENGER (Germany) said that his delegation preferred article 5, variant B, in the version contained in document A/CN.9/470. Moreover, it would prefer the text of variant B to remain unchanged: the amendment proposed by EBF ("unless the debtor consents....") was ambiguous.

23. While his delegation was generally in favour of the Federation's proposed amendment to article 6 (l), he suggested that the words "for the sale or lease of goods or the provision of services" should be deleted since some types of contract to be covered under the article—for example, construction contracts—would otherwise be excluded.

24. Mr. DOYLE (Observer for Ireland) said that, like the representative of Germany, he preferred variant B in the version contained in document A/CN.9/470.

25. Mr. DUCAROIR (Observer for the European Banking Federation) said that the proposed amendment to draft article 5 reflected the desire of the Working Group on International Contract Practices and of the Commission to remove unnecessary limitations on the draft Convention's scope of application. However, the wording of the amendment was misleading; it appeared to further limit the application of articles 11 and 12, whereas the intention had been to expand the scope of those articles as much as possible. He suggested that the problem should be referred to the drafting group.

26. He had no objection to the German representative's suggestion for the further amendment of article 6 (l). The primary purpose of the amendment proposed by EBF had been to establish a general regime for trade receivables and a specific regime for financial receivables, which could be defined in greater detail if delegations wished.

27. The CHAIRMAN suggested that the problem should be referred to the drafting group.

28. Mr. SCHNEIDER (Germany) said that it was not always possible to make a clear distinction between substantive issues and drafting problems, but that he was prepared to accept the Chairman's suggestion.

29. Mr. SMITH (United States of America) said that, while he agreed that there was general consensus at the level of policy, various issues required further consideration.

30. The common view seemed to be that all provisions of the draft Convention should apply to trade receivables, however defined. The question then was what rules applied to receivables other than trade receivables. Under variant B, in the case of receivables other than trade receivables, if the underlying contract contained an anti-assignment clause, articles 11 and 12 of the Convention did not apply.

31. However, variant B might prove inadequate in certain cases. If articles 11 and 12 did not apply owing to the existence of an anti-assignment clause, domestic law would prevail; however, anti-assignment clauses were not enforceable under some national legal systems, in which case the provisions of the draft Convention that governed relations between assignor and assignee would apply. Moreover, even in States where anti-assignment clauses were enforceable, the effect of making an assignment despite the existence of such a clause might vary from State to State; it might prevent the assignment from becoming effective or enable the debtor to claim breach of the clause itself.

32. The Commission should consider whether the choice of law rules embodied in the draft Convention should give priority to the jurisdiction of the assignor in such cases or, if the financial receivable was a claim against a broker or a depositary bank, whether the choice of law rule should rather be the location of the debtor, as was the case in some jurisdictions and as was rapidly becoming the modern rule in the case of investment securities. If the Commission concluded that assignment should be effective even in the presence of an anti-assignment clause, it must also decide whether that fact would affect the debtor's right to set off mutual rights and obligations as provided under the legislation of certain States. His delegation also had grave doubts as to the warranty and substantive law proceeds provisions in such situations. The Commission might therefore need to establish specifying exclusions for certain receivables, other than trade receivables.

33. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that draft article 6 (l) was based on the assumption that, where the application of articles 11 and 12 of the draft Convention was excluded, the validity of any anti-assignment clause would be a matter of party autonomy. However, that presumed well-structured financial arrangements between sophisticated parties capable of protecting their own rights; the Commission might wish to provide further protection against adverse effects arising from application of the Convention.

34. The Commission should also consider what effect would be produced by deletion of the words "Unless the debtor consents" from the European Banking Federation's proposed amendment to draft article 5. Of course, the draft Convention would not affect the assignment arrangements contained in the original contract agreed to by assignor and debtor. However, the assignor must consent to any arrangements between assignee and debtor that affected the original contract. The question was whether the Convention should establish whether debtors could waive the protection to which they were entitled under an assignment clause, even where national law allowed them to do so.

35. The problem posed by the definition of trade receivables might be resolved by redrafting the text, replacing "for the sale or lease of goods or the provision of services" with "for the supply of goods, works or services".

36. Thus, apart from the issue of the assignment clause, the Commission might consider the potential for any other untoward effects of the draft Convention on the rights of debtors or third parties; the question of a debtor's right to change the assignment arrangements through negotiation with the assignor or the assignee; the possibility of revising the definition of trade receivables; and the issue of whether references to payments or security settlement systems and receivables arising under financial contracts governed by netting agreements or used as collateral were appropriately included in such a definition in the context of a multilateral treaty.

The meeting rose at 1.05 p.m.

Summary record of the 677th Meeting

Monday, 12 June 2000, at 3 p.m.

[A/CN.9/SR.677]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 3.05 p.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4)

1. Mr. SMITH (United States of America)* said that his delegation would like to propose the following text for inclusion in articles 6 and 4:

"Article 6. *Definitions and rules of interpretation*

"For the purposes of this Convention:

"(x) (i) Except as provided in subparagraph (x)(ii), a "receivable" is a contractual right to payment of a monetary sum, owed by a person ("debtor") to an assignor, as:

"(A) Payment for goods sold or leased or for the provision of services [other than financial services];

"(B) Payment for industrial or other intellectual property sold or licensed;

"(C) Payment for a credit card transaction;

"(D) Repayment of a loan of money, regardless of the currency in which denominated; or

"(E) Reimbursement for the payment, pursuant to a guaranty, suretyship obligation, [or other secondary obligation], of the debtor's obligation to a third party.

"(ii) The following are not "receivables":

"(A) Rights to payment arising from transactions on a regulated futures exchange;

"(B) Rights to payment arising from the sale, lease or loan of gold or other precious metals;

"(C) Rights to payment under a financial netting agreement;

"(D) Rights to payment under bank deposit relationships, including those arising under inter-bank payment systems;

"(E) Rights to payment from an insurer under an insurance contract, or from a reinsurer under a reinsurance contract;

"(F) Rights to payment for goods sold or leased to the extent that under the law of the State where the goods are located the goods are considered to be part of the real estate on which the goods are situated;

"(G) Drawing rights or rights to payment under a letter of credit or independent bank guarantee;

"(H) Rights to payment arising from foreign exchange contracts; or

"(I) Rights to payment arising from the sale or lending of investment securities, including repurchase agreements and rights to payment arising under investment securities settlement systems.

"Article 4. *Exclusions and limitations on application of certain provisions*

"(3) In the case of receivables described in subparagraphs (D) and (E) of article 6 (x) (i), articles 11 and 12 do not affect the rights and obligations of the debtor [or any guarantor, surety or other secondary obligor for the debtor] unless the debtor [or such guarantor, surety or secondary obligor] otherwise consents".

2. Each category of payment rights that would not constitute receivables under the Convention should be reviewed and compared with variant B of article 5, since the list of exclusions would accomplish what the members of the Commission had intended to achieve with variant B of article 5.

3. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) said that more time was needed to study the proposal just made by the United States. That delegation might wish, however, to have a second look at its proposed definition of a receivable. Indeed, if the definition was dependent on the fact that there was an assignor, it would be difficult to establish the existence of a receivable before it was assigned, since only by assigning the receivable did a creditor become an assignor.

4. Mr. BERNER (Observer for the Association of the Bar of the City of New York) said that the text proposed by the United States contained clear and useful changes that would eliminate many instruments and transactions that had no place in the Convention. It would also restore the Convention's focus and make it more workable.

5. Mr. PICKEL (Observer for the International Swaps and Derivatives Association (ISDA)) said that ISDA was an international organization with offices in the United States, London and Tokyo. An office was also due to be opened later in the year in Singapore. ISDA had 500 member institutions from 37 countries and represented the privately negotiated derivatives industry. Its principal role was the development of the standardized documentation used throughout the world to document bilateral relationships between parties in the field of derivatives.

6. The relationships between parties on which ISDA contracts were based evolved over time through additional transactions and through fluctuations in the market value of the underlying transaction entered into pursuant to a master agreement. One of the most important clauses in the master agreement established the single agreement concept, according to which all transactions entered into relied on the fact that the master agreement and all the transactions formed a single agreement between the parties, who would not otherwise enter into any transaction.

7. That provision was important to the concept of netting, which applied to several areas of contracts. When a relationship was terminated, for example, very specific provisions in ISDA contracts provided for obligations under all transactions to be

*The United States proposal was subsequently issued as document A/CN.9/XXXIII/CRP.4.

terminated with one net amount being owed by one party to the other. ISDA supported variant B of article 5 because it protected the concept of netting. It believed, however, that the types of exclusions proposed by the United States would be even more beneficial and would better recognize the relationship nature of the contract.

8. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the United States proposal introduced significant changes in the scope of application of the draft Convention. It therefore raised a question of policy, namely, whether the Commission wished to proceed with the elaboration of a list of practices which should be excluded from the Convention. If it decided to so proceed, it would then have to examine the various types of practices described in order to determine whether they qualified for exclusion and then justify each exclusion. A secondary issue was whether, following the adoption of such a restrictive definition of receivables, the Commission would find it necessary to spell out a long list of exclusions.

9. Mr. SMITH (United States of America) said that, while his delegation appreciated the issue of policy which the Secretary of the Working Group had just raised, it considered the scope of the draft Convention to be quite broad. If members of the Commission had been asked at the beginning of the process what types of transactions were to be covered by the draft Convention, no one would have thought of foreign exchange transactions, swaps, sales of investment property or rights to payment from investment accounts. Instead they would have thought only of such transactions as the sale or lease of goods, service contracts, credit card receivables and loans, all of which they currently had difficulty in effecting. But, given the high volume of the flow of payments in those categories, there would be no contraction of the scope and importance of the Convention if the class of receivables were confined to those categories. Indeed, given the novelty of creating uniform rules for all States, confining those rules to the receivables that generated the highest volume and highest value with the least opposition from other financial sectors would constitute a great victory for the Convention.

10. Mr. SCHNEIDER (Germany) said that the United States proposal posed two problems of policy. First, it must be borne in mind that the Convention needed to be geared to the special needs of the banking industry. The second problem concerned the scope of the draft instrument. While variant B of article 5 dealt with one special problem, the new proposal, with its new ideas and new language, would revisit the broader problem of the type of receivables that should be included in the Convention. Given the limited time available, the Commission should not reopen the discussion and should focus instead on the broad scope of application of the Convention.

11. Mr. FERRARI (Italy) supported the statement just made by the representative of Germany. Before it could accept the United States proposal, the Commission would have to consider each exclusion. His delegation would have difficulty, for instance, with the exclusion of the rights to payment referred to in (ii) (A) of the United States proposal. It supported variant B of article 5.

12. Mr. MORÁN BOVIO (Spain) said that the United States proposal should be examined calmly and dispassionately. Indeed, the text might help to meet the concerns which the Commission wished to address. The main problem with the list of exclusions was its failure to address certain realities. He hoped that the observers attending the meeting, who were perhaps in closer contact with the business world, would help to further clarify certain elements of the United States proposal.

13. Mr. DUCAROIR (Observer for the European Banking Federation) agreed with the representative of Spain that the United States proposal, which was an innovative one, deserved careful study. At the previous session of the Working Group on International Contract Practices, the mandate of the Federation had been to seek the exclusion of financial receivables from the scope of application of the Convention. That proposal, however, had not won broad enough support from the members of the Working Group, who had considered that the scope of application of the Convention should not be limited in such a drastic manner. After careful consideration the members of the Federation had come out in favour of variant B of article 5, subject to the inclusion in article 6 of various definitions of what was not a receivable.

14. The Federation had been taken by surprise by the United States proposal, a quick perusal of which had revealed that the list of exclusions did not fulfil all the wishes of banking and financial circles and left unanswered questions such as those relating to settlements of assets on the stock exchange, which, even though they were receivables, were not included in the scope of application of the Convention. He therefore believed that elements of the Federation's proposal in document A/CN.9/472/Add.1 should be incorporated into the text proposed by the United States of America, should the latter find favour with members of the Commission.

15. Mr. SALINGER (Observer for Factors Chain International) said that a wide range of transactions was currently subject to factoring. Since his association firmly supported a convention on assignment of receivables as a highly useful instrument in international trade, he would be reluctant to see the exceptions proposed by the United States adopted without a careful examination of each one to determine whether or not it was a factoring transaction, a process that would take many hours. Perhaps it was too late in the proceedings to reopen the question.

16. Mr. DESCHAMPS (Observer for Canada) said that variant B of article 5 of the draft Convention sought to exclude financial receivables from the scope of articles 11 and 12. The United States proposal went much further by completely excluding all sophisticated financial receivables, although it left ordinary financial receivables, such as bank deposits and loans, within the scope of the draft Convention but exempt from the application of articles 11 and 12. While the proposal might appear complex, in essence it revolved around the question of whether to remove sophisticated financial receivables from the scope of the draft Convention altogether, and the Commission could decide that point without considering each subparagraph of the United States proposal in detail.

17. Mr. DOYLE (Observer for Ireland) said that the Commission had begun with a long list of exceptions to the definition of receivables and had reduced that list to the three exclusions set forth in article 4. It was perhaps too late to start the discussion over again. Although the definition of a trade receivable remained to be decided, at least that issue was narrow and should be capable of a quick solution, whereas consideration of the United States proposal might take the entire session.

18. Mr. BERNER (Observer for the Association of the Bar of the City of New York) said that the issue was whether it was safer to err on the side of including transactions that should not be in the draft Convention or of excluding transactions that should be in the draft Convention. In his view, it was better to leave types of transactions the Commission had not specifically focused on to be covered by existing law.

19. Mr. STOUFFLET (France) said that his delegation was not ready to take a position on the interesting and complex United States proposal, but his first reaction was that it showed a lack of confidence in the capacity of the draft Convention to handle assignments of receivables other than trade receivables. Although

he was quite prepared to address the well-identified technical needs of financial institutions, such as the need to protect settlement systems, he was unaware of the legal or technical justification for some of the other broad exceptions proposed, such as transactions involving gold. Nor was he convinced by the argument that trade receivables were the largest class of assignments numerically, since matters of principle should not be decided by statistics.

20. Mr. WHITELEY (United Kingdom) said that, although his delegation understood the fear that lists might create more problems than they solved, it was important for the draft Convention to state clearly the criteria governing inclusion or exclusion. The exceptions proposed by the United States appeared to fall into three categories. One category concerned instruments that were traded on financial markets, such as securities or gold. Since such assets were easily transferable, they should perhaps be excluded. The second category related to receivables for which the application of article 11 raised concerns. Although an attempt had been made to address those concerns in variants A and B of article 5, the United States proposal constituted an alternative solution. The third category consisted of receivables that did not fall easily within the priority rules set forth in the draft Convention, which generally provided that priority of claims to a receivable would be determined according to the law of the assignor's location. There were types of receivables, such as land or securities, for which that result might be inappropriate or conflict with other international obligations of potential signatories of the draft Convention. For European Union countries, there were concerns about a possible conflict with the Community directive on settlement finality in payment and securities settlement systems. His delegation felt that it was necessary to exclude such items in order to make the draft Convention workable.

21. Mr. SMITH (United States of America) said that many delegations had criticized his delegation for the late submission of a complex proposal. He wished that it could have been otherwise. Part of the process, after formulating a set of rules, was then to circulate them broadly to solicit opinions on their practicability and acceptability from the groups that would be affected by them. It was through that process that his delegation had arrived at its list of inclusions and exclusions and had realized that it could not fail to bring to the attention of the Commission the resistance and objections it had encountered. The Commission's goal must be to draft a convention that did the best job possible for the largest number of receivables without, however, posing problems for any industry or trade groups.

22. Mr. SALINGER (Observer for Factors Chain International) said he understood that the United States delegation had consulted with industry groups in the United States, not worldwide. Whereas factoring in the United States tended to be restricted to certain trades, its use worldwide was much broader. Great care would be required in considering each exclusion in order not to weaken the usefulness of the draft Convention.

23. Mr. IKEDA (Japan) said that his delegation would need time to consider the very important United States proposal. Since the outcome of the discussion would influence the choice between variants A and B of article 5 of the draft Convention, article 6 should be considered before article 5.

24. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that it might be useful to clarify the basic differences between an approach based on article 5 and one based on the United States proposal. Variant B of article 5 would leave the decision as to the effectiveness of assignment to other law, but that law might or might not recognize the validity of clauses limiting assignability even for other than trade receivables. For greater protection of the rights of the debtor, the United States was proposing outright exclusion of certain types of receivables from the scope of the Convention. Its proposal consisted of a list of inclusions and a list of exclusions. The Commission might wish to know whether the lists were intended to be exhaustive or merely indicative and what criteria had been applied in drawing up the lists.

25. The CHAIRMAN said that further discussion of the United States proposal should be postponed until it was available in all languages.

26. He invited the Commission to consider article by article the text of the draft Convention submitted by the Working Group in document A/CN.9/466.

Article 1

27. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the Working Group had adopted all of article 1 except for paragraph 3, which referred to chapter V and might be taken up in conjunction with that chapter. However, the commentary (A/CN.9/470) and comments by Governments (A/CN.9/472 and Add.1-4) had identified issues the Commission might wish to consider.

28. One such issue was whether paragraph 1 *(b)* should, like paragraph 1 *(a)*, require the assignor to be located in a Contracting State. With regard to paragraph 1 *(c)*, the United States had suggested a drafting change to make it clear that assignments under paragraph 1 *(c)* were not actually a different category from assignments under paragraph 1 *(a)*. In relation to paragraph 2, it was suggested in paragraph 17 of the commentary (A/CN.9/470) that the Commission might wish to consider specifying the time at which the debtor needed to be located in a Contracting State or the receivable needed to be governed by the law of a Contracting State. Paragraph 16 of the commentary suggested that the Commission might wish to address the question of whether the courts of a non-Contracting State would apply the draft Convention only if its substantive and territorial requirements were met.

29. Mr. COHEN (United States of America) said that, although his delegation supported the policy underlying paragraph 1 *(b)*, which was intended to cover a chain of assignments, it felt that the present wording was misleading. As written, paragraph 1 *(b)* appeared to override both conditions set in paragraph 1 *(a)*, namely, that either the receivable or the assignment must be international and that the assignor must be located in a Contracting State, whereas the intention had been merely to eliminate the requirement of internationality. The result could be to make the draft Convention applicable in cases where a subsequent assignee would have no reason to suppose, and no opportunity to ascertain, that it would apply. His delegation had proposed, in document A/CN.9/472/Add.3, that paragraph 1 *(b)* should read:

> "*(b)* A subsequent assignment by an assignor located in a Contracting State at the time of the conclusion of the contract of assignment, provided that any prior assignment is governed by this Convention; and".

30. Mr. MORÁN BOVIO (Spain) questioned whether the wording proposed by the United States might not interfere with the principle of continuatio juris, as discussed in paragraphs 18 and 19 of the commentary (A/CN.9/470), particularly in the case of securitization transactions.

31. Mr. COHEN (United States of America) said that his delegation generally supported the principle of continuity but nevertheless felt that it had its limits. If it led to surprising results that the original assignor and assignee could not have anticipated, it had been taken too far. Requiring the assignor to be located in

a Contracting State would give some notice to the parties involved that the draft Convention might apply.

32. Mr. SCHNEIDER (Germany) observed that there could be no element of surprise since both the assignee and the assignor would always be aware of the application of the Convention in prior assignments. There was therefore no need to change the text of paragraph (1) *(b)* to include a rule governing exceptions.

33. Mr. FERRARI (Italy), concurring, said that an assignor would always know the nature of the receivables. Only the assignee might in certain instances be under the mistaken impression that all assignments were domestic because of the location requirement. The text should therefore not be changed.

34. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) endorsed the position of the German and Italian representatives.

35. The CHAIRMAN said that there seemed to be no support for the proposed United States amendment to article 1 (1) *(b)*.

36. Mr. COHEN (United States of America) drew attention to his delegation's proposed wording for article 1 (1) *(c)* (A/C.9/472/Add.3, p. 4) and said that the problem, as the Secretary of the Working Group had already explained, was one of clarity, not of substance.

37. The CHAIRMAN said he took it that the Commission wished to refer the United States proposed amendment to article 1 (1) *(c)* to the Drafting Group.

38. *It was so decided.*

39. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices), referring to article 1 (2), pointed out that whereas in article 1 (1) the Convention applied only if the assignor was located in a Contracting State at the time of the conclusion of the contract of assignment, article 1 (2) did not deal with the issue of the time when the debtor needed to be located in a Contracting State. For the sake of consistency, the Commission might wish to specify the time of conclusion of the original contract also with regard to the location of the debtor, even though by doing so it would create a degree of uncertainty as to the application of the Convention, a disadvantage discussed at the end of paragraph 17 of the commentary (A/CN.9/470). It should be noted that the proposed amendment to article 39 (A/CN.9/470, para. 215) also took the same approach on the issue of time, as did article 3 in connection with the internationality of a receivable.

40. Mr. MORÁN BOVIO (Spain) said that including a reference to the time of the original contract in article 1 (2) would clarify the text.

41. Mr. FERRARI (Italy), concurring, recalled that the issue had come up in connection with the Convention on International Factoring, and the adoption of a similar rule had created no problems.

42. The CHAIRMAN said he took it that the Commission wished to refer the stipulation of a time in article 1 (2) to the Drafting Group.

43. *It was so decided.*

44. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) recapitulated the points set out in paragraph 16 of the commentary (A/CN.9/470) with reference to article 1 and said that the Commission might wish to address the admittedly minor question that arose in relation to the application of the Convention by courts of a non-Contracting State.

45. Mr. FERRARI (Italy), supported by Mr. MORÁN BOVIO (Spain), said that if the assignor was not located in a Contracting State, the court of a Contracting State would have to decide whether or not the Convention applied, and whether it applied by virtue of article 1 (1) *(a)* or of applicable private international law. A court in a non-Contracting State would not be bound by the draft Convention. However, the problem referred to by the Secretary of the Working Group arose when the rules of private international law of a non-Contracting State required the law of a Contracting State to be applied. In such a case, a judge in a non-Contracting State would be precluded from looking into the matter. If, on the other hand, no rule of private international law applied, the judge must look into the matter and apply the draft Convention if the requirements of article 1 (1) *(a)* were met in the non-Contracting State.

46. Since no rules could ever be made for non-Contracting States, the text should be kept as it was, with the Convention being applicable whenever the requirements of article 1 (1) *(a)* were met.

47. The CHAIRMAN said he took it that the Commission wished to retain the text of article 1 (1) *(a)*.

48. *It was so decided.*

Article 2

49. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that a number of issues had been raised by Governments and organizations (A/CN.9/472 and Add.1-4) and in the commentary (A/CN.9/470, pp. 12-17). With reference to article 2 *(a)*, there was a proposal by France (A/CN.9/472, p. 6) that, as a minimum, non-contractual receivables should be covered by the draft Convention, through the introduction of an optional system. Furthermore, paragraphs 30 to 34 of the commentary (A/CN.9/470) suggested that: the Convention should cover the assignment of non-monetary rights convertible to a monetary sum and non-monetary contractual rights to performance; it should be made clear that not only all but also part of a receivable could be covered by the Convention; and it would be well to clarify in both article 2 and article 9 that the statutory limitations on assignment, other than those addressed in article 9, were not covered by the Convention.

50. Mr. STOUFFLET (France) said that his delegation would still prefer to extend the scope of article 2 to include non-contractual receivables. There were practical reasons for so doing: the assignment of non-contractual receivables was a very widespread practice, as in the case of the reimbursement of value added taxes. There were also legal reasons: different legal systems had different definitions of the term "contractual", thus making it difficult to apply article 2 as drafted. If the limitation only to contractual receivables was eliminated, however, the Working Group would face a drafting problem, for many articles referred to the contract from which the assigned receivable arose. Rather than redrafting all such references, the problem could be handled by including a general statement that what was meant in all cases was the "act" giving rise to the assignment. If, however, the Commission wished to maintain the limitation, the inclusion of an option system would indeed be a compromise solution.

51. Mr. AKAM AKAM (Cameroon) did not object to the scope of the draft Convention being extended to non-contractual receivables, which were sometimes quite substantial.

52. Mr. SCHNEIDER (Germany) said his country had always favoured the inclusion of non-contractual receivables. He supported the compromise proposed by the representative of France.

53. Mr. COHEN (United States of America) commented that several substantive provisions in the existing text, such as the rules on debtor protection, debtor's discharge by payment and the location of the debtor, would not work so well if applied to non-contractual receivables. It was not merely a question of extending the scope of the draft Convention. Every individual rule in the text would have to be tested in order to ascertain whether it would work for non-contractual receivables, and he wondered whether the Commission was prepared to do that. A possible solution would be for the Commission to decide to confine the present draft articles to contractual receivables and to adapt its future work on secured credit to cover non-contractual receivables.

54. The CHAIRMAN observed that the Commission would indeed have to re-examine all the draft articles if it intended them to apply to non-contractual receivables. That was an important point to consider.

55. Mr. DOYLE (Observer for Ireland) said that his delegation, which had originally favoured the inclusion of non-contractual receivables, now accepted the view of the Working Group that it was better to exclude them. As the text now stood, the draft articles implied exclusion, and the text might be damaged by attempting to include non-contractual receivables.

56. Mr. FERRARI (Italy) said that it was not merely a question of drafting. If it became optional to include non-contractual receivables, a judge located in a Contracting State which had chosen that option would have to apply the Convention even if it would not otherwise apply.

57. Mr. ONG (Singapore) agreed with the representative of the United States that it would be simpler to confine the Convention to contractual receivables.

58. Ms. McMILLAN (United Kingdom) said that it would not be a good idea, at the present late stage of drafting, to include non-contractual receivables in the scope of the Convention. Virtually all the draft articles would have to be reviewed, and the problem of swaps and derivatives would have to be dealt with. That would place too much strain on the text. It would be better to provide for non-contractual receivables in a separate draft.

59. The CHAIRMAN concluded that there was no consensus within the Commission for departing from the Working Group's position on non-contractual receivables.

60. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that draft article 2 *(a)* did not at present address the issue whether part of a receivable was assignable. However, the position of a debtor in a partial assignment had to be addressed within the substantive provisions of the draft Convention, because in some cases, a debtor receiving a notification concerning a partial assignment might be asked to make part payment to different persons. The position of the debtor in such cases could be addressed in the context of the debtor's discharge, in draft articles 18 and 19. There was also the question of rights convertible to money and non-monetary contractual rights to performance. Such rights, if assigned, might be receivable under more than one regime. The assignment of rights convertible to money might already be implicitly covered in the draft articles, since those rights would become contractual receivables if there were in effect an agreement that they should be convertible.

61. Mr. MORÁN BOVIO (Spain) objected to the idea of making provision for the assignment of parts of a receivable, which could create difficulties for both the debtor and the assignee. It was important to preserve the principle of the unity of the receivable.

62. Mr. STOUFFLET (France) said that the absence in the draft articles of any mention of assignment of parts of receivables did not necessarily mean that they could not be assigned. Although not regulated by the Convention, such assignments might be permissible. He suggested that the point should be clarified in the commentary.

63. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the validity of partial assignments was confirmed in draft article 9. The insertion of the words "all or part" in article 2 *(a)*, as proposed in paragraph 32 of document A/CN.9/470, would mean that the remainder of the draft Convention also applied to partial assignments. That would cover the position of a debtor faced with notification of a partial assignment and with requests by different people for payment of parts of a receivable.

64. Mr. SALINGER (Observer for Factors Chain International) said that in factoring it was difficult to invalidate assignments of parts of receivables. Goods might be delivered under a contract over a period of several months and be payable in separate parts. Where the whole of a sum due was to be assigned, difficulties would arise if there was no provision for the assignment of parts. It was also common practice, in some jurisdictions, for assignments to be split between different factors or to be shared among factors.

65. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) agreed with the previous speaker. Partial assignments were common in non-recourse factoring, part of a receivable being taken by way of purchase and the rest being collected without that part of the receivable being assigned. It was important not to invalidate such practices.

66. Mr. FERRARI (Italy) said it was not necessary for the Convention to spell out that parts of receivables were assignable, since that could be inferred from article 9. One of the underlying principles of the draft was to promote assignment as such, and that in itself validated the assignment of parts of receivables.

67. Ms. WALSH (Observer for Canada) endorsed the comments just made. However, it was important to have explicit confirmation of the validity of partial assignments. As for the concern that a debtor would be exposed to dealing with multiple assignees and multiple payments, she suggested, as a compromise, that draft article 11 should be confined to the whole of a receivable. That would mean that a debtor who included in the original contract a restriction for partial assignments would be able to rely on the restriction at a later stage.

68. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that, if the words "all or part" were inserted in draft article 2 *(a)* before "of the assignor's contractual right", the draft Convention as a whole, and not merely article 9, would apply to partial assignments. The question of protecting the debtor in partial assignments could be discussed in the context of draft articles 18 and 19, or in the context of draft article 11, as suggested by the representative of Canada.

69. The CHAIRMAN said that there appeared to be a consensus within the Commission for validating partial assignments.

The meeting rose at 6 p.m.

Summary record of the 678th Meeting

Tuesday, 13 June 2000, at 10 a.m.

[A/CN.9/SR.678]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.10 a.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4)

Article 2

1. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that one issue relating to article 2 was whether assignments of rights that were non-monetary but could be converted into money would be covered. The Commission might wish to clarify whether they were affected by the United States proposal, in which case they would be discussed in that context at a later stage. The other question was whether assignments of contractual rights other than rights to payment—performance rights—should also be covered. If not, there could be two different regimes covering one assignment of contractual rights: one for the assignment of payment rights and another for the assignment of performance rights. The practical value of the assignment was the receivable, but often other performance rights might have some value as security.

2. The understanding of the Working Group was that statutory assignability was not affected by the draft Convention; however, that was not explicitly stated in the draft text. It might be useful to clarify that issue in the scope provisions in article 2, or in article 4, for example by saying that the draft Convention did not affect statutory assignability or that the assignment of a receivable that was non-assignable under law applicable outside the draft Convention was not covered by the draft Convention. Some additional language might be required in article 9 to ensure that it did not affect statutory assignability, at least other than statutory requirements referring to the assignment of future receivables or to bulk assignments.

3. Unilateral assignments, referred to in paragraph 30 of the commentary, were very rare in practice. When the assignee received the receivable, there was at least an implicit agreement. If a conflict arose before that stage, it might be useful for it to be covered by the draft Convention. The Commission might wish to consider whether those types of unilateral assignment should also be covered.

4. With regard to partial assignments, the words "all or part of the assignor's contractual right to payment" would be included in article 2 and the issue of the debtor's legal position in the case of a partial assignment could be taken up either in the context of the discussion of the debtor's rights in article 17 or 18 or, as suggested by the representative of Canada, in the context of article 11. That was a matter for further discussion. The same was true of paragraph 4 of article 1, which would be discussed in the context of article 40, dealing with the different options available to States with regard to the annex.

5. Ms. SABO (Observer for Canada) suggested that the question of partial assignments should be taken up when the Commission discussed those articles at a later stage.

6. Mr. WINSHIP (United States of America) also wished to consider those issues at a later stage. He asked whether the reference to partial assignments referred to partial assignments and to assignments of undivided interests, which were both covered by article 9. His concern was that the language to be added to article 2 might not cover undivided interests. That issue could appropriately be taken up in the context of article 9, or when the rights of debtors were discussed. When a policy decision had been taken, the drafting group should decide on the language.

7. The CHAIRMAN suggested that the drafting group should be given at least an indication of policy at the present time. He assumed that the position of the United States was that the reference to partial assignments should cover all forms of partial assignments of interests, whether divided or not.

8. Mr. WINSHIP (United States of America) confirmed that assumption, but noted that the debate should take place in the context of article 9. In any event, language should not be adopted without considering both partial assignments and assignments of undivided interests.

9. The CHAIRMAN noted the agreement to defer discussion of that issue until article 9 was discussed and invited the Commission to consider assignments of performance rights.

10. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the Working Group had reached agreement on the issue of partial assignments or assignments of undivided interests in receivables in the context of article 9. In article 2, the Working Group's suggestion had been to add language to ensure that those types of assignments were covered and that the whole draft Convention applied to them. The other issue was the position of the debtor in the case of an assignment of a partial receivable or an undivided interest in receivables. He understood that the Commission's policy would be to add some language in article 2 to cover those cases, and that the position of the debtor would be discussed later. Also, in the context of article 9, the Commission could consider the appropriateness of the policy decisions and the wording of those articles.

11. The CHAIRMAN noted that there seemed to be little support for making provision for performance rights in the draft Convention. Perhaps the report should show why the Commission had decided not to explicitly provide for those rights.

12. Mr. MORÁN BOVIO (Spain) felt that non-monetary rights and performance rights were a relatively small issue and that those two questions might not fit in well with the objective of the draft Convention. Reference to non-monetary receivables, which could in the future be converted into monetary receivables, might introduce difficulties into the text. The matters raised in paragraphs 30 and 31 of the commentary were relatively new for the Commission.

13. Mr. STOUFFLET (France) agreed that inclusion of non-monetary performance rights would open a door to the unknown. There were prerogatives accessory to the receivables, which in most cases would naturally be transmitted with the receivables,

but there would be doubts in other cases. For example, the commentary referred to the possibility of cancelling the contract, in the case of non-payment of the receivable. It did not seem appropriate that the assignee of a contractual receivable should be able to cancel the contract. It might be advisable to exclude that possibility from the scope of the Convention, since those rights were not clearly defined. The Commission might simply indicate in the commentary in very general and prudent terms that the rights accessory to the receivables were transmitted to the assignee.

14. Mr. SCHNEIDER (Germany) shared the opinion of the French and Spanish delegations. The draft Convention need not cover the assignment of non-monetary performance rights, which were not very often used in practice. As far as partial assignments were concerned, the proposal relating to article 2 would raise both a drafting problem and a policy problem. His delegation would postpone any further remarks on partial assignments until the discussion of article 9.

15. The CHAIRMAN said that it was clear that the Commission as a whole would prefer not to deal with the issue of non-monetary rights. The next issue was statutory assignments. If the Commission decided not to deal with statutory assignments, it might be useful to include the reasons for that decision in the report.

16. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the status of statutory assignments was clear from the definition of assignments, which referred to agreements. The Working Group had decided that only assignments made through an agreement would be covered, and not assignments by operation of law.

17. Statutory assignability was a separate issue, and the Working Group had reached the understanding that it referred to the limitations as to the assignment of certain receivables. The Commission could decide whether that understanding was appropriate and whether it should be explicitly stated somewhere in the draft text. At present there was no such reference. One could deduce that the statutory assignability of receivables was not affected by the draft Convention from articles 11 and 12, which dealt with contractual assignability and contractual limitations but not with statutory assignability. One might arrive at the same deduction from article 9, which dealt with the assignment of future receivables or bulk assignments but not with other types of receivables that might not be assignable under law. It might be useful to make it clear in article 2 or article 4, in the scope part, that the draft Convention applied to receivables, unless they were unassignable by law. Reference could then be made to article 9: future receivables might not be assignable by law but such statutory limitation to assignment would be set aside by the Convention. It should be made clear that with the exception of what was covered in article 9—limitations to the assignment of future receivables and bulk assignments—the Convention did not affect statutory limitations. That point might also need to be reflected in articles 2 or 4. Paragraph 35 of the commentary gave examples from the European Contract Principles and the UNIDROIT Principles on Assignment.

18. Ms. SABO (Observer for Canada) said that the issue raised by Mr. Bazinas related to the effectiveness of an assignment of a monetary right and would appropriately be dealt with, if an explicit provision was needed, in article 9. The draft Convention applied to the assignment of a receivable. However, where there was a statutory prohibition on assignment of the kind of receivable in question, which was applicable under national law, the assignment might not be valid. The issue should therefore be dealt with in article 9, and not in the provisions on scope.

19. The CHAIRMAN noted that the issue would be considered in the context of article 9 and invited the Commission to consider the issue of unilateral assignments.

20. Mr. MORÁN BOVIO (Spain) said that, if the door was left wide open for unilateral assignments, the assignor would be able to convey a great many present and future receivables to another person and so deplete its assets and create a difficult situation for other creditors. That very thorny issue should not be included in the text.

21. The CHAIRMAN assumed that the Commission would prefer to leave the text as it was: in other words, unilateral assignments would not be considered within the scope of the draft Convention.

22. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) responding to the comment made by the observer for Canada, said that the question whether an assignment of receivables owed by a government was effective if under other law that receivable was not assignable was indeed an issue of effectiveness. There could be a problem in excluding from the scope of application of the draft Convention receivables that might not be assignable by contract. Whether the debtor was a financial institution or a government, it should be treated consistently.

23. The CHAIRMAN said that the Commission would revert to the issue in the context of article 9.

Article 3

24. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the Working Group had adopted the text of article 3, which defined an international receivable and an international assignment with reference to the location in different States of the assignor and the debtor, in the case of a receivable, and the assignor and the assignee, in the case of an assignment. One point that might need to be clarified was the critical time for the determination of internationality. The Working Group had noted that, in the case of an assignment of a future receivable, where the internationality depended only on the internationality of the receivable, the assignor and the assignee would not be able at the time of the assignment to determine whether that domestic assignment would be covered by the draft Convention. The Working Group had found that to be an inherent but acceptable weakness.

25. The CHAIRMAN assumed that the Commission was satisfied with article 3.

Article 4

26. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that article 4 (1) *(b)* was intended to exclude documentary receivables. However, as legal systems differed in their interpretation of what constituted such a receivable, it had been decided to focus on the manner of transfer (delivery and endorsement) of the instrument. Article 4 (2) had been placed in brackets pending the Commission's final decision on the scope of application of the draft Convention. The intention had been to give States a basis for excluding practices not explicitly excluded in the draft Convention.

27. Mr. COHEN (United States of America) said that the words "with any necessary endorsement" in article 4 (1) *(b)* suggested that the exclusion did not apply if the instrument was delivered without endorsement; in some legal systems, the applicable law was determined by the location of the object rather than by that of the assignor. He would therefore prefer to delete those words but was prepared to leave the matter to the drafting group.

28. Ms. SABO (Observer for Canada) said that, while she supported the substance of the proposal made by the United States

representative, she wondered whether the intended result would be achieved by deletion of the words "with any necessary endorsement". She agreed that the matter should be referred to the drafting group.

29. Mr. FERRARI (Italy) asked for confirmation of his delegation's understanding that the assignment of non-consumer receivables for consumer purposes was excluded under article 4 (1) *(a)*.

30. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) confirmed that understanding.

31. The CHAIRMAN said he took it that the Commission wished to refer article 4 (1) *(b)* to the drafting group, to postpone consideration of article (4) (2) until the scope of the draft Convention had been established and to return to article 4 once the proposal made by the United States delegation had been distributed in all languages.

32. *It was so decided.*

Article 5

33. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the Commission would doubtless prefer to postpone further discussion of article 5 until the United States proposal had been distributed. However, it might also wish to consider whether to exclude the transfers of dematerialized negotiable instruments. The issue had not been discussed in the Working Group but was mentioned in paragraphs 44 and 176 of the analytical commentary to the draft Convention (A/CN.9/470). The latter paragraph raised the issue of conflicts of priorities; the prevailing view on the matter was that such conflicts were more appropriately governed by the law of the intermediary's location rather than that of the assignor.

34. Mr. SMITH (United States of America) said that his delegation had endeavoured to address the issue of dematerialized securities in its proposal on the scope of the draft Convention and suggested that the issue should be postponed until that proposal had been distributed. The drafting group should also address the problem.

35. Ms. KESSEDJIAN (Observer for The Hague Conference on Private International Cases) said that Australia, the United Kingdom and the United States had made a written proposal on conflicts of law rules relating to dematerialized securities at the May 2000 session of the Special Commission on general affairs and policy of The Hague Conference on Private International Law. She wondered what impact the Commission's decision on the matter would have on the work of the Conference.

36. Mr. SMITH (United States of America) said that the potential for conflict between the decisions taken by different international and regional bodies working in related legal fields did not prevent the Commission from considering such matters.

37. Mr. MORÁN BOVIO (Spain) cautioned against excessive haste in dealing with important issues such as transfers of dematerialized securities and suggested that the Commission should concentrate on clarifying general issues rather than becoming bogged down in specific details.

Article 6

38. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) drew attention to the fact that article 6 *(c)* and (l) had been placed in brackets.

39. Article 6 (i) provided a definition of location, which was one of the key issues because it determined the draft Convention's scope of application. For example, the law of the State in which the assignor was located was of great importance in the context of articles 24 to 27, which dealt with conflicts between multiple claimants to a receivable.

40. Article 6 (i) was based on the fact that the place where the central administration of the assignor or the assignee was exercised was easily determined and, moreover, was the place where insolvency proceedings relating to the assignor were likely to be opened. However, as noted in paragraphs 69 and 70 of the analytical commentary to the draft Convention (A/CN.9/470), the definition of "location" did not address the question whether priority should be given to the place of central administration in conflicts between the head office and a branch office, or between two branch offices, of a financial institution. At a late stage of the Working Group's deliberations, it had been suggested that in such cases priority should be given to the law of the State in which the branch office rather than the head office was located.

41. The CHAIRMAN proposed that the Commission should consider article 6 *(c)* together with the preamble to the draft Convention at a later date and that article 6 (l) should be discussed in the context of the proposal made by the representative of the United States.

42. *It was so decided.*

The meeting was suspended at 11.20 a.m. and resumed at 11.55 a.m.

43. The CHAIRMAN invited the Commission to continue its consideration of draft article 6 (i).

44. Mr. DUCAROIR (Observer for the European Banking Federation) suggested that discussion of the draft article would be premature, since the final text depended on whether the Commission adopted variant B or the proposal put forward by the representative of the United States at the preceding meeting. In the former case, it would be important to define the word "location" because branch offices were particularly widespread in the banking and financial professions. If, on the other hand, the United States proposal was adopted, financial receivables would ipso facto be outside the scope of the draft Convention. Consideration of the draft article should therefore be deferred until a choice had been made between those alternatives.

45. Mr. MORÁN BOVIO (Spain) drew attention to his delegation's proposal, which appeared in document A/CN.9/472/Add.2. Its purpose was to deal with situations in which it was not clear from the original contract which location was most closely related to the contract, when a debtor had a number of establishments throughout Europe. It was a minor point, but agreement on the proposal had been reached in the Working Group and it would be as well to settle the matter before moving to other issues.

46. Mr. FRANKEN (Germany) was opposed to any deferral of the discussion on draft article 6 (i): branch offices were found not only in banking but also in other industries, such as insurance. In previous discussions, it had been broadly agreed that there was no point in adopting specific provisions relating to branch offices, if such offices had no relation to the main place of business. The phrase "closest relationship to the original contract" provided the most satisfactory solution. The drawback to the suggestion that the location should be deemed the place where a transaction was entered was that that location could not always be determined. In an electronic age, a company might enter all transactions centrally; but, by the same token, branch officials—

and the taxation authorities—would insist on immediate access to transactions entered in the branch concerned, which would thus also have its own central book-keeping. He therefore supported the proposal by the representative of Spain. Failing that, the United States proposal might provide an appropriate solution.

47. Mr. SALINGER (Observer for Factors Chain International) said that, after 30 years' experience in factoring cross-border receivables, his organization knew that, in the case of small businesses, it was not always easy to identify the location of the central administration. It had therefore proposed, in document A/CN.9/472/Add.2, that draft article 6 (i) should be amended to specify that, if the assignor had a place of business in more than one State, the place of business was that place where the central administration was exercised. If the debtor had a number of places of businesses in the same State, the problem did not arise. As for the suggestion by the representative of Spain, the deciding factor should be the State in which the place of business was located to which the invoice was to be addressed, or at least the location from which payment had to be made in accordance with the contract.

48. Mr. STOUFFLET (France) had doubts about identifying the place of business as that with the closest relationship to the original contract. That might be a logical approach when considering the debtor, who was a party to the basic contract, but not as applied to the assignor. He therefore believed that the location should be the place where the assignment contract was made.

49. Mr. MEENA (India) said that, since the phrase "habitual residence" could lead to unnecessary controversy, in that it was difficult to define, it should be replaced by the phrase "ordinary place of residence".

50. Mr. FERRARI (Italy) agreed with the observer for the European Banking Federation that the phrase "more than one place of business" was relevant only when the locations were in more than one country. As for the proposed change from "habitual residence" to "ordinary place of residence", he would, for the sake of consistency with earlier texts adopted by the Commission and those of other organizations, favour retaining the existing text. Moreover, it had become easier to trace a habitual residence.

51. Mr. DOYLE (Observer for Ireland) concurred. Some problems had only an approximate solution and legal definitions could not always be established with mathematical precision. The three proposed amendments should be adopted only if members were adamantly opposed to the existing text.

52. Mr. SALINGER (Observer for Factors Chain International) said that a small company might have its place of business in one country but its central administration elsewhere, for example if the chief executive controlled it from a tax haven. That was why he favoured the phrase "place of business in more than one country" over "more than one place of business".

53. The CHAIRMAN asked how the proposed amendment would be treated in a federal State, which had more than one jurisdiction.

54. Mr. SALINGER (Observer for Factors Chain International), supported by Mr. DESCHAMPS (Observer for Canada), said that, for the purposes of the draft Convention, different jurisdictions would be considered as different States.

55. Mr. FERRARI (Italy) disagreed; he would explain his reasons when the clause relating to federal States was discussed. As for the point made by the observer for Factors Chain International, he said that the draft Convention would not apply to a central administration that was not a place of business. A problem arose only if the central administration was considered a place of business, in which case the debtor could indeed be said to have a place of business in more than one country.

56. Mr. BERNER (Observer for the Association of the Bar of the City of New York) said that the Observer for Factors Chain International had drawn attention to an ambiguity in the text. If a company had branches at two different places in the same city, the current text could be interpreted to mean that there was more than one place of business, and that could give rise to inconsistency. The text of article 6 (i) could be read in two different ways, which could lead to two different solutions.

57. Mr. SALINGER (Observer for Factors Chain International) said that, if the Italian representative's interpretation of the text was correct, his organization would have no problem. However, to a layman, the text was not clear, as had been pointed out by the previous speaker. His organization's suggestion would deal with that ambiguity.

58. Mr. MORÁN BOVIO (Spain) said that his delegation did not feel that there was any way of improving the drafting of article 6 (i). The suggestion put forward by the secretariat in paragraph 70 of document A/CN.9/470 could provide a possible formula.

59. Mr. SMITH (United States of America) said that on the issue of how to deal with a contract for the supply of goods to a debtor's branches in several countries, where it was difficult to determine which country had the closest relationship to the contract for purposes of determining the location of the debtor, his delegation would suggest a different approach: the location of the debtor should be the State of the debtor's central administration. If the central administration rule was merely a supplemental rule in cases where the closest relationship could not be determined, a problem would arise because assignors would not want to be concerned about whether their determination of the closest relationship might later be questioned. His delegation felt that that approach would offer greater certainty, and a more objective way of dealing with the problem, if the Commission wanted to address the issue at all.

60. Mr. STOUFFLET (France) said that the location of the assignor had very important consequences because it determined the regulation of conflicts of priorities. The text of article 6 (i) implied that it was always the law of the main place of business that applied. However, it was a common practice for the central banks of a State to receive assignments from branches of foreign banks in the territory of that State, and the central banks would not want such assignments to be governed by the law of the main offices of those foreign banks, which would be the consequence of the text as it stood. The French central banks were therefore insisting that the location of the branches of assigning banks should be determined in the same way as the location of the debtor. If article 6 (i) was left as it stood, some of those central banks would insist that his Government should not sign the Convention.

61. Mr. RENGER (Germany) said that his delegation fully shared the concerns of the French delegation. The problem arose not only for central banks, but for all companies and corporations which had branches. The place of business of the assignor, the assignee, and the debtor should be determined in a consistent manner.

62. Mr. DUCAROIR (Observer for the European Banking Federation) said that the Federation was very concerned about the problem of determining the location of the assignor. The current text of article 6 (i) was not satisfactory to the profession he represented and, if it was retained, the banks might invoke

article 8 and set aside the application of the Convention. The proposals of the European Banking Federation could be found in document A/CN.9/472/Add.1. The current wording of article 6 (i) extended the scope of the draft Convention in an unnecessary and unrealistic manner. The problem arose also in relation to assignments to commercial banks. The text of article 6 (i) therefore needed to be modified.

63. Mr. DESCHAMPS (Observer for Canada) said that his delegation understood the concerns of the delegations of France and Germany. However, it should not be forgotten that the main objective in establishing the location of the assignor was to determine the applicable law in cases of conflicts of priorities between two assignees. The situation in which an assignor made assignments to two different establishments, and the law invoked was different in each case, must be avoided; the problem could not be solved unless the assignor had only one location. It was for that reason that the Working Group had recommended that the location of an assignor with several establishments should be the place of the central administration. While that solution was not perfect, it was not possible to achieve perfection.

64. Ms. STRAGANZ (Austria) said that her delegation aligned itself with the concerns expressed by the representatives of France and Germany, and would support a consistent solution regarding the location of the assignor, the assignee and the debtor.

65. Mr. FERRARI (Italy) said that his delegation supported the comments made by the observer for Canada, and would prefer to leave paragraph 6 (i) as it stood.

66. Mr. MORÁN BOVIO (Spain) said that his delegation fully supported the comments made by the observer for Canada. The solution put forward by the secretariat in paragraph 70 of document A/CN.9/470 might provide an acceptable formula. If branches and separate offices of a bank, or other entity, that were located in different States were regarded as separate banks, that would avoid the problems described by France and the European Banking Federation.

The meeting rose at 1 p.m.

Summary record of the 679th Meeting

Tuesday, 13 June 2000, at 3 p.m.

[A/CN.9/SR.679]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 3.05 p.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.4)

Article 6 (continued)

1. The CHAIRMAN said that serious concerns of policy had been expressed with regard to the definition, in draft article 6 (i) of the location of parties to the contract. The Commission also had before it a drafting amendment proposed by the representative of India, to replace the term “habitual residence” by “ordinary place of residence”.

2. Mr. MORÁN BOVIO (Spain) objected to the proposal. No sufficiently weighty reasons had been given for departing from the standard term used in the present text.

3. The CHAIRMAN said that the text should therefore remain as it was. A further proposal, by the representative of France, was that location should be a function of a link with the contract of assignment rather than with the original contract.

4. Mr. SMITH (United States of America) was persuaded, by the comments of the representative of Canada, that there had to be one location for the assignor when there was more than one assignment. If there was one rule for determining location in the case of a particular assignment and a different rule for a second assignment, it was hard to see how the same priority rules could be said to apply.

5. The CHAIRMAN said that before tackling substantive issues the Commission had to decide whether to adopt a drafting proposal made by the observer for Factors Chain International, whereby the debtor’s place of business, if in more than one location, would be defined as being in different States. He had also proposed that, if it was not clear which State had the closest link with the original contract, it should be the State from which the payment would emanate.

6. Mr. SALINGER (Observer for Factors Chain International (FCI)) explained that in the Working Group he had suggested a reference to the place to which the invoice would be addressed. However, the objection had been raised that in some cases there was no invoice. It was therefore better to designate the place from which payment would emanate according to the original contract.

7. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) supported the FCI proposal.

8. Mr. SALINGER (Observer for Factors Chain International (FCI)), explaining his first proposal, said that the location of the assignor would be defined in the following terms: “If the assignor has a place of business in more than one State, the place of business is the place where the central administration is exercised.”

9. Mr. BERNER (Observer for the Association of the Bar of the City of New York) supported the proposed amendment, which would remove an element of ambiguity in the text.

10. The CHAIRMAN said that the question would be referred to the Drafting Group.

11. Mr. SALINGER (Observer for Factors Chain International (FCI)), commenting on his proposal concerning the location of the debtor, recalled the point made by the representative of Spain, that it was difficult to determine the location of a business for the purposes of the Convention where a contract took effect in a plurality of States, for instance where a debtor ordered goods for delivery in several States under the same contract. That was why he had proposed that the place of business should be that from which payment was to emanate.

12. Mr. SCHNEIDER (Germany) did not support the proposal. There were already problems of interpretation in determining the place most closely associated with the original contract. The proposal would tend to water down the existing definition and create further problems. He preferred to adhere to the policy adopted in the Working Group.

13. Mr. MORÁN BOVIO (Spain) favoured the proposal, which was intended merely to create a residual rule for cases in which it was impossible to determine which place of business had the closest relationship to the original contract or to the debtor.

14. Mr. DOYLE (Observer for Ireland) agreed with the representative of Germany that the term "closest relationship" was too vague and lent itself to a variety of interpretations.

15. The CHAIRMAN observed that the purpose of the FCI proposal was to provide a mechanism for identifying the applicable law in cases where the place of business could not be readily defined.

16. Mr. MORÁN BOVIO (Spain) said that in the light of the comments by the observer for Ireland and the representative of Germany he was willing to leave the text as it stood.

17. The CHAIRMAN invited the views of the Commission on the substantive issues raised by the representatives of France and Germany.

18. Mr. DUCAROIR (Observer for the European Banking Federation (EBF)) said that the Federation was intent on finding a satisfactory solution for defining the location of a branch in cases where the same receivable was assigned by establishments dependent on the same head office but located in different countries. The text of its amendment to draft article 6 (i) in document A/CN.9/472/Add.1, *("(iii) if the assignee has more than one place of business, the place of business is that which has the closest relationship to the assignment contract")* should be followed by: "If the application of this rule designates more than one place of business of the assignor or assignee (located in different States), the relevant place of business is that place where its central administration is exercised." The purpose of that amendment was to provide a suppletive rule for those very rare cases in which the general rule, of the branch with the closest link to the contract, would not suffice because the same receivable was being assigned by different branches.

19. Mr. SCHNEIDER (Germany) requested some clarification. Choosing the place of central administration of a bank would not solve the problem raised earlier by the representative of France.

20. The CHAIRMAN said a distinction had to be drawn between two separate issues: first, the question of defining in a consistent manner all the locations of the parties to a contract; and, second, how to deal with different branches of a bank involved in the same assignment. It had to be decided whether the existing text, which provided different definitions of the location of a debtor or assignor/assignee, should be maintained, or whether there should be a single definition covering the location of all parties.

21. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) explained that the reason why the Working Group had adopted an approach based on the place of central administration was to ensure not only that priority issues were referred to a single jurisdiction but also that the location would normally be the principal insolvency jurisdiction for the assignor. The different approach adopted towards the debtor was intended to ensure that the debtor protection system would function in a consistent and predictable manner.

22. Mr. MORÁN BOVIO (Spain) defended the existing text, which had been arrived at after lengthy discussion in the Working Group. Different criteria were applied because the aims pursued were different. It was not feasible to have a single rule applying to the location of the debtor, the assignor and the assignee, because the two latter might have nothing to do with the original contract, so the test of "closest relationship" could not be applied to them. However, the existing text did not entirely resolve the problem of branches, namely, those parts of credit or insurance entities which operated outside the normal location of the business.

23. Mr. SALINGER (Observer for Factors Chain International (FCI)) said that the proposed definition would affect factors. Factoring consisted of a considerable body of relatively small transactions. It was a straightforward matter to identify the assignor, but with a multiplicity of debtors it would be very difficult to decide where the central place of business of each was located. That was why he had opted for the place where the payment would originate. Leaving the definition as it stood at present would make it simpler for factors to provide services and credit.

24. Mr. SMITH (United States of America) welcomed the explanation by the Secretary of the Working Group regarding a different rule of location for assignors and assignees, as opposed to debtors. In most cases, the existing text would serve its purpose well. However, there was a problem in the case of banks, and perhaps insurance companies, having different branches. Banks routinely operated in foreign jurisdictions through branches, in order to take advantage of capital rules applying to enterprises, and were often governed by different regulations in each foreign jurisdiction. It might be desirable for the Commission to consider having a separate rule of location for such branches, but without undermining the general rule formulated by the Working Group, which seemed to offer the best solution for receivables assigned by business entities other than banks.

25. Mr. DUCAROIR (Observer for the European Banking Federation (EBF)), after reading out his proposal a second time, said that while it had been drafted in an improvised manner and was therefore imperfect, it reflected a strong concern on his part that the current text of the Convention should be retained as drafted, leaving the question of conflicts of priority unresolved. Such conflicts might arise in cases where two branches of the same bank were assignors of the same receivable, although such cases were rare. He wished to establish a general rule that the place of business should be the branch having the closest relationship to the operation concerned. As a subsidiary point, in the extremely rare event that two branches were designated by the application of that rule, then the place of business should be the place where central administration was exercised.

26. The CHAIRMAN asked the previous speaker to elaborate on how the application of his first rule could lead to more than one place of business being designated, since the rule provided that the place of business was that which had the closest relationship to the original contract.

27. Mr. DUCAROIR (Observer for the European Banking Federation (EBF)) said that the following example would illustrate

the point he wished to make. The French bank, Banque Nationale de Paris (BNP) had a branch in London and one in New York. On the assumption that the same receivable was assigned inadvertently by both the London and the New York branch, the application of the rule concerning closest relationship would designate either of those branches, which might create a conflict of priorities. It was therefore necessary to designate a single point of reference so as to permit implementation of the rule on priority laid down in the draft Convention.

28. Mr. MORÁN BOVIO (Spain) said that, rather than endeavouring to grapple with the entire issue raised by the representative of EBF, the Commission should focus on a very specific aspect of it, namely, the question of separate branches and offices of credit or financial institutions, as appropriate. In that connection, the proposal made by the secretariat in paragraph 70 of document A/CN.9/470, that the Commission should take into account article 1 (3) of the UNCITRAL Model Law on International Credit Transfers, might resolve the issue under consideration. In accordance with the provision cited, branches and separate offices of a bank in different States were separate banks. The wording, which in his view would also cover insurance companies, constituted a good starting-point for the drafting of article 6 (i).

29. Mr. DESCHAMPS (Observer for Canada) said that, while regarding branches as separate legal entities might be an attractive solution at first glance, it raised more difficulties than it resolved. In the case of banks, conflicts of priority occurred most frequently in situations where a loan was inadvertently assigned twice. For example, the headquarters of a bank might assign a loan portfolio to the central bank of another country, and the portfolio might be administered by a place of business of the bank located in a country different from the one in which the headquarters was located. The need therefore arose for a single rule in order to resolve conflicts of priority. To state that the headquarters and the branch should be regarded as separate legal entities did not solve the problem, because it was possible that the two assignments had been made by places of business which had not been involved in granting the loan and thus had no relationship to the original contract. Further provisions would then be necessary in order to clarify the question of which place of business was the owner of the receivable.

30. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) suggested that, in order to meet the concerns expressed by the representative of Spain and the observer for Canada, a subparagraph should be added to draft article 6 (i), reading: "If the assignor or the assignee has more than one place of business, the place of business is that place where its central administration is exercised. If the assignor or the assignee is a branch of a financial service provider or an insurance institution, the place of business is the place of that branch which has the closest relationship to the contract of assignment."

31. Mr. SMITH (United States of America) asked the Chairman to confirm his understanding that, while the existing text of draft article 6 (i) was generally acceptable to the Commission, there might be a need for a separate location rule for branches of banks and perhaps also insurance companies.

32. The CHAIRMAN said it was his understanding that the question before the Commission was as the United States representative had formulated it.

33. Mr. SMITH (United States of America) drew attention to suggestions made by his delegation in the Working Group which were very similar to what the Secretary of the Group had suggested (A/CN.9/466, para. 98).

34. Ms. McMILLAN (United Kingdom) suggested that the Commission should revert to the drafting suggestion made by the representative of EBF. Her delegation was satisfied with that suggestion, which addressed some concerns of EBF that were shared by the British Bankers Association and also dealt with the questions of multiple assignment and priority. Whether it solved the problems relating to branches of banks and to insurance companies was another matter.

35. Mr. SCHNEIDER (Germany) expressed appreciation to the representative of the United Kingdom for drawing attention to the EBF proposal. His delegation believed that the proposal would solve all the outstanding problems, including those relating to branches of banks and insurance companies. The basic rule that would be applied in all situations was that of the closest relationship to the original contract. In the case of conflicts of priority, the place of central administration would be decisive.

36. Mr. SALINGER (Observer for Factors Chain International (FCI)) said that any provision relating the location of the assignor to that of the original contract would destroy the whole benefit of the draft Convention to the factoring industry, which dealt with a large stream of contracts. There was no way for the factor to know whether a factoring agreement was or was not a factoring agreement under the draft Convention. The proposal might be helpful to bankers, but it was very unhelpful to his industry.

37. Mr. DOYLE (Observer for Ireland), drawing attention to the report of the Working Group (A/CN.9/466), said that the Commission was revisiting a debate that had taken place at the Group's previous session. The question of whether there should be a separate rule for branches had been the subject of intense debate. A number of difficulties had been raised, including problems of definition, which might have been solved by the United States proposal. However, two more fundamental objections remained. One was that a separate rule for branches might undermine the basic rule of central administration. The other was that such a rule would constitute an injustice to third parties, since a third party could not be expected to know what the administrative structure of a bank or other organization was. In the light of those difficulties, he did not believe that the Commission was ready to adopt a separate rule for banks or branches.

38. Mr. MORÁN BOVIO (Spain) drew attention to the proposal made at an earlier session by the United States delegation in the Working Group (A/CN.9/466, paras. 98 and 99). It had suggested that if a special rule were to be used for branches and offices separate from a bank, the location should be defined as the place where the operation was recorded in the account books. There had been a great deal of opposition to that suggestion, because in an age of electronic accounting entries could be made anywhere, making it difficult to determine where the accounting was being done. Accordingly, another solution must be found. The proposal by the secretariat helped to move the debate forward and was preferable to that of EBF.

39. Mr. STOUFFLET (France) said that his delegation, like that of Germany, supported the EBF proposal, with one reservation. The reference to the closest relationship to the original contract, which was valid when the debtor was involved, was not valid when the assignor was involved; in that case, what should be retained was a reference to the assignment contract.

40. Ms. WALSH (Observer for Canada) said that the first part of the EBF proposal was cast in general terms, so that all assignors and all assignees would be located in the State which had the closest connection with the original contract. It was her understanding that the representative of France would support that general rule. She recalled that when the Working Group had considered that possibility in the past, it had rejected it for the

reasons identified by the observer for FCI, namely, the uncertainty and unpredictability it would create in the case of a bulk assignment of international receivables and in the case of an assignment of future receivables. In the first case, there might be a number of States whose laws would apply to different receivables within the same assignment, and, in the second case, it would not be possible to determine in advance the State with the closest connection to the original contract.

41. Mr. DUCAROIR (Observer for the European Banking Federation (EBF)) said that while the remarks made by the observer for Canada were very pertinent, they became less so if the French proposal was regarded as referring not to the original contract but to the assignment contract. He emphasized that his proposal was intended to apply to all receivables; he was not seeking a special rule.

The meeting was suspended at 4.25 p.m. and resumed at 4.55 p.m.

42. Mr. SMITH (United States of America) said that his delegation was not happy to see the issue of location re-opened. Although not entirely satisfied with the text produced by the Working Group, his delegation could support it in a spirit of compromise. His delegation's original aim had been to achieve certainty, not only by locating the assignor in one State only, but by defining the assignor's location objectively as the place of jurisdiction in which an entity was legally organized or incorporated. After debate, his delegation had agreed to support the wording "place where central administration is exercised" as being far more certain than "closest relationship to the original contract". It would be a step backward to reject the Working Group's conclusions and to create a less certain and more fact-intensive location rule. The value of the draft Convention would be diminished and the flow of credit restricted in consequence.

43. Mr. MORÁN BOVIO (Spain) said that his delegation agreed with the United States position. Having circulated the draft in Spain, where it had met with a largely positive reaction, he was reluctant to re-open the issue. The only question that remained to be decided was whether a special rule should be devised for branches.

44. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) said that the Working Group had discussed at length all aspects of location, and all the arguments raised at the present meeting had been raised earlier. All the problems had been resolved except the question of branches, which had two aspects: scope of application of the draft Convention and questions of priority. Any solution adapted to one aspect tended to be imperfect from the standpoint of the other. The main need of business was for certainty. Exceptions ultimately led to litigation. His organization would opt for the text as it stood.

45. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that, with some trepidation, he would revive an old idea as a possible solution. With regard to scope of application, a desire for flexibility was evident, so that the draft Convention could have the widest possible application. On the question of priority, however, certainty was the primary concern. It was essential to avoid the result of multiple jurisdictions or conflicts with the UNCITRAL Model Law on Cross-Border Insolvency.

46. As a solution, the Commission might wish to reconsider the possibility of having a flexible rule of location for purposes of scope, while retaining the place-of-central-administration location rule for questions of priority. Without special treatment for branches, the acceptability of the draft Convention, especially to financial institutions, might be impaired.

47. Ms. McMILLAN (United Kingdom) said that the advantage of the approach suggested by the Secretary of the Working Group was that it would clearly indicate why location was defined differently for different purposes.

48. Mr. SCHNEIDER (Germany) said that his delegation had been in favour of the EBF proposal, but since it obviously had not met with consensus, a compromise position must be sought. The approach just suggested was one possible solution, although perhaps not the best. He would like to insist on one point, namely, that any rule that applied to branch offices of financial service providers should also apply to branches of companies in other industries. In Europe companies were increasingly doing cross-border business through branches.

49. The CHAIRMAN said that the discussion of a special rule for branches, of banks in particular, had taken a dramatic turn. Perhaps it was time to re-examine whether there was really a need for a special rule for branches, as suggested by the observer for Ireland. There appeared to be support for the notion that any rule formulated should apply generally and not be limited to branches of financial service providers.

50. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) said that the answer depended on the motive for a special rule. If the purpose was to expand the scope of application of the Convention to transactions emanating from branch offices, most participants would be in favour. However, with regard to questions of priority, care must be taken not to lose the certainty achieved by the present text.

51. Mr. MORÁN BOVIO (Spain) said that revisiting the reasons why a special rule was required for branches might help lead to a solution. If there were no such valid reasons, article 6 (i), which distilled the efforts of the Working Group, appeared to be acceptable to most. In no event, however, should there be separate rules for scope and for jurisdiction. That would be a step backwards. The Commission should limit itself to the narrow question of branches.

52. Mr. SMITH (United States of America) said that his delegation strongly supported the views of the representative of Spain. The Working Group had decided not to follow the approach earlier alluded to by the Secretary of the Working Group because of the importance of certainty not only as to priority but also as to application of the draft Convention. The search for flexibility would undermine certainty. If there were two different location rules for scope and priority, extenders of credit would have to undertake two investigations, one to determine whether the draft Convention applied and another to determine the applicable law. Two different rules might produce inconsistent effects. The Working Group had rejected the two-step approach primarily because of the practical difficulties involved in applying it, rather than for reasons of doctrinal purity.

53. If special rules were devised for bank branches, it would be for reasons of practical necessity. However, outside that specific area, his delegation would insist on preserving the location rule as set forth in article 6 (i).

54. Mr. WHITELEY (United Kingdom) said that his delegation agreed with the secretariat that the issue was primarily one of enforceability of claims in insolvency. The problem was that different jurisdictions took different approaches to the insolvency of corporations and particularly banks. The approach taken in the United Kingdom was to allow all creditors to participate in proceedings. Some other jurisdictions preferred to favour the interests of local creditors, particularly in the case of financial institutions, an approach which might be incompatible with a rule

that applied a single location to the assignor based on place of central administration.

55. Mr. DOYLE (Observer for Ireland) said that the Commission should bear in mind its decision to have a single rule and that the text of article 6 (i) should therefore be retained. The only unsettled issue was whether there should be a separate rule for bank branches.

56. Ms. SABO (Observer for Canada) agreed with the representative of the United States that the reasons why the Working Group had chosen not to have separate location rules were valid and that settled issues should not be revisited.

57. Mr. IKEDA (Japan), concurring, said that the text as it stood was acceptable and workable. Special rules were generally not desirable, but in the case of branches one was needed.

58. Mr. DUCAROIR (Observer for the European Banking Federation (EBF)) said that a separate rule for bank branches would serve the purposes of central banks alone, which received assignments from other banks. It would not help commercial banks at the front line of operations, which generally received assignments not from banks but from industrial firms and the like. Hence his Federation's proposals had sought to reconcile the views of those who favoured the place-of-central-administration location rule and those who favoured the place-of-business-with-the-closest-connection rule.

59. Mr. MORÁN BOVIO (Spain) reiterated that the general rule was acceptable and said that the only question still before the Commission was whether a special rule for bank branches was needed and what was meant by the term "branch".

60. Mr. DESCHAMPS (Observer for Canada) said that the issue was narrow in scope if the focus was solely on branches. The problem of locating the assignor arose only if the assignor had more than one place of business, namely, an office or branch.

61. The CHAIRMAN observed that the discussion had not yielded sufficient support for either the EBF proposal or the proposal based on the UNCITRAL Model Law on Cross-Border Insolvency or the proposal by the Secretary of the Working Group for two separate rules. The consensus therefore seemed to be that article 6 (i) should be left as it stood, except for the question of branches, which must encompass branches of every type, not simply those of financial institutions. There seemed, however, to be a feeling that there was no need to address the question of branches for inclusion in the draft Convention.

62. Mr. SMITH (United States of America) endorsed the comments of the observer for Canada. There was agreement among delegations when only one place of business was involved and disagreement when there was more than one: that was the crux of the matter. Yet, to have a different rule for branches was to have a different location rule and would mean that the whole issue was being reopened. Only a text for some sub-category of branches, such as those of banks or insurance companies, would not necessitate a reopening of the issue.

63. Mr. DESCHAMPS (Observer for Canada) concurred. The current location rule did not deal with branches in more than one State.

64. The CHAIRMAN said that since the Working Group had already provided a text on branches in general, the question was settled, and there was no need for further discussion.

65. He invited the United States delegation to introduce the proposals submitted in document A/CN.9/XXXIII/CRP.4, which were intended for inclusion in articles 6 and 4.

66. Mr. SMITH (United States of America) said that, as indicated by the observer for Canada the previous day, receivables fell into three categories: one to which all the rules of the Convention applied in their entirety; a second to which many of those rules applied, although a few needed to be adjusted to take account of market practices and expectations; and a third where the Convention had little impact and might cause some harm, and where those who participated in the assignment of those receivables were highly sophisticated, working under rules devised for themselves and other participants.

67. Paragraph (x) (i) of the United States proposal listed the receivables which the Commission definitely wanted the draft Convention to cover: it would be noted that subparagraph (i) (A), reflecting the language of article 6 (l) of the current draft, included the right to payment for goods sold or leased or for the provision of services other than financial services, but did not include real-estate receivables, for which the Convention rules might not be suitable because the Convention's choice-of-law rule was at variance with the rule chosen for such receivables in many countries and was likely to meet with resistance. He recalled that at the beginning of the session the Under-Secretary-General for Legal Affairs had said that real estate was a common form of collateral and that the draft Convention was designed primarily to permit the extension of credit in situations where real-estate collateral was not available, especially to the less wealthy.

68. The draft Convention should also cover the sale or licensing of trademarks, patents, copyrights, trade secrets and other intellectual property, as indicated in subparagraph (i) (B). World economies were shifting from goods-based economies to information-based economies and the type of receivable involved was a key receivable of the modern age. Credit card transactions (subparagraph (i) (C)); loans (subparagraph (i) (D)); and various financial accommodations that resembled loans (subparagraph (i) (E)) should also come under the draft Convention.

69. Paragraph (x) (ii) of the United States proposal listed receivables that were excluded from the draft Convention, some of which might otherwise fall into the categories given in paragraph (x) (i). For instance, rights to payment for the sale of goods regularly traded on commodities exchanges in a regulated financial market that did not need the Convention because assignments were made through commodity brokers following their own entirely different rules (ii) (A) were excluded. Similarly excluded were receivables arising from the sale, lease or loan of gold or other precious metals (ii) (B), which were viewed as currency by the metal-lending industry, in the sense of the obligation to repay, and were traded in regulated markets and off-markets through standard forms and master agreements among sophisticated parties. Another exclusion applied to receivables resulting from netting agreements (ii) (C), which had also troubled the European Banking Federation, for the sophisticated parties involved did not need the Convention. Receivables resulting from bank-deposit relationships and inter-bank payment systems (ii) (D) or from insurance or reinsurance contracts (ii) (E) were also excluded. He would discuss the remaining exclusions, including (ii) (F) about which his delegation felt the least strongly, at the following meeting.

70. His delegation's proposed amendment to draft article 4 dealt with exclusions in relation to loan receivables involving anti-assignment clauses that were applied in the loan syndication and participation market, which would be harmed by the provisions of articles 11 and 12 of the draft Convention.

The meeting rose at 6 p.m.

Summary record of the 680th Meeting

Wednesday, 14 June 2000, at 10 a.m.

[A/CN.9/SR.680]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.05 a.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.4)

1. The CHAIRMAN invited the Commission to resume discussion of the United States proposal regarding the scope of the draft Convention (A/CN.9/XXXIII/CRP.4).

2. Mr. MORÁN BOVIO (Spain) said that he fully supported the substance of the proposal but that it might be best to move the list of items which were not receivables under the draft Convention to article 4.

3. Mr. IKEDA (Japan) said that, since adoption of the proposed amendments to article 6 and article 4 would require the deletion of article 5, the proposal should be considered as a package. The great advantage of the proposal was that it would obviate the need to use the term "trade receivable"; article 73 of the analytical commentary to the draft Convention (A/CN.9/470) noted that the definition of "trade receivable" was similar but not identical to the use of the term in the Ottawa Convention. Moreover, although paragraph 53 of the commentary referred to "the well-known notion of "trade receivable", that term was not well known in Japan and, in fact, had not been used in the Working Group until the most recent session.

4. It was not the United States delegation but the European Banking Federation which had first proposed that the draft Convention should include a list of items not considered receivables for the purposes of that instrument. At the time, the Working Group had objected to the idea on the grounds, inter alia, that such a list could not be exhaustive. The proposal currently under consideration should therefore be subjected to close scrutiny.

5. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) said it was his understanding that in the United States proposal the list of items to be considered receivables under the draft Convention was intended to be indicative rather than inclusive but that the list of items not considered receivables was exhaustive. He requested clarification of the matter.

6. Mr. SMITH (United States of America) said that, on the contrary, the items defined as receivables in the first part of his delegation's proposal were intended to be the only ones covered by the draft Convention; the list was very broad and covered virtually all receivables to which that instrument would normally apply. The list of items not considered receivables applied directly to exclusions from the former list.

7. The CHAIRMAN pointed out that the proposal did not allow for the possibility of receivables which did not currently exist but which might one day need to be covered by the draft Convention.

8. Mr. SMITH (United States of America) said that, as the Commission had no way of knowing what such items might be, it could not predict what rules might apply to them. For the foreseeable future, receivables arising out of the sale or lease of goods, the provision of services, loan monies and the licensing of information accounted for virtually all receivables qualifying for cross-border financing.

9. Mr. FRANKEN (Germany) said that, since governments had had over five months in which to consider the draft Convention and to submit comments thereon, it was somewhat unfair of the United States delegation to present such a comprehensive proposal at a very late date.

10. Moreover, the proposal had fundamental weaknesses; the list of items considered receivables for the purposes of the draft Convention was intended to be exhaustive but might contain loopholes. It would therefore require extremely close study in order to determine whether its definition was broad enough to cover, inter alia, receivables stemming from dividends, interest payments and interest paid on the basis of security loans. His own delegation considered that, as a matter of principle, the draft Convention should begin with a more general definition of receivables before listing exclusions.

11. The Commission had before it another proposal, that of the European Banking Federation, which had been submitted in a timely fashion and was in line with the Working Group's most recent deliberations. Only if the Federation's text proved unacceptable should the possibility of discussing the United States proposal be considered.

12. Mr. TELARANTA (Finland) said that he agreed with the representative of Germany.

13. Mr. WHITELEY (United Kingdom) said that he shared the German delegation's concern regarding the timing of the proposal and the need to consider its impact. However, the United States representative had explained that the proposal had arisen from issues raised by United States financial institutions; such consultation was important, and the United States financial services industry had an impact that extended beyond its national territory. Moreover, the proposal addressed issues that had not been fully covered in that of the European Banking Federation.

14. The draft Convention could be amended in several ways. In addition to the issues of scope raised in the United States proposal, the Commission might wish to consider changing the rules governing the priority of interests in land, bank accounts and securities held in systems such as Euroclear; his own delegation would prefer in such cases to give priority to the location of the land or the account. He also shared the United States delegation's concern at the potential impact of the draft Convention on netting agreements, where the mandatory rules applied outside the Convention would mean that an assignment in breach of a contractual prohibition of assignment was effective. However, article 5, variants A and B, of the existing draft also addressed those issues. Thus, his delegation supported the general principles embodied in the new proposal but would like more time to review it.

15. Mr. AKAM AKAM (Cameroon) said that he shared the concerns expressed by the representative of Germany, particularly as some of his own delegation's proposals had been rejected on the grounds that they had been submitted too late in the discussion process. He was also opposed to listing the receivables covered by the draft Convention; it would be better to define those receivables in general terms and to list only the exclusions. Further details could be provided in a set of legislative guidelines, as in the case of other UNCITRAL conventions.

16. Mr. STOUFFLET (France) said that adoption of the new proposal would radically change the very purpose of the draft Convention. The Working Group had decided to give that instrument as broad a scope as possible. At a later stage, it had felt the need to ensure that application of the draft Convention and, in particular, its provisions on anti-assignment clauses would not disrupt the function of certain collective netting regulatory mechanisms and had therefore made a distinction between trade receivables and financial receivables; the former would not be excluded from the scope of the instrument but would be covered by a special regime.

17. Suddenly, the United States delegation had proposed a long list of receivables to be covered or excluded. While he was not in a position to determine whether that list was well-founded or not, he feared that receivables which might come into being in the future would not be covered. Furthermore, delegations would need at least six months or a year to consult their national specialists regarding what would be, in essence, a new instrument, the very name of which would have to be changed if the United States proposal were adopted.

18. France's banking professionals had initially been reluctant to support the draft Convention, not because of its provisions but because they would have preferred to leave the industry to regulate itself without interference from international bodies. With some difficulty, they had been induced to support the new instrument, but he did not know whether they would agree to the changes contained in the United States proposal.

19. Mr. MORÁN BOVIO (Spain) pointed out that the Commission was not a diplomatic body whose members were obliged to seek and follow instructions from their Governments. The issue of timeliness was irrelevant and public criticism of the United States delegation on those grounds inappropriate. The Commission should focus on the substance of the proposal.

20. Mr. GHAZIZADEH (Islamic Republic of Iran) expressed general support for the United States proposal, which he considered helpful, but sought clarification about items and instruments which were not included in the list and might need to be added in the future.

21. Mr. DOYLE (Observer for Ireland) expressed surprise at the vehemence of the attack on the United States proposal on the grounds of its timing. It had been common in the Working Group for delegations to submit draft proposals at short notice. It was quite unrealistic to contemplate a further six months of discussion. Moreover, the elements of the proposal were not new: it was a response to problems that had been raised at the Working Group—and on which the Commission had invited the Working Group's views—and had remained unresolved. The representative of France was correct in stating that the draft Convention contained definitions of the word "receivable"; but they had not met with universal satisfaction. Those whom he had consulted in Ireland considered the scope of the definition to be too broad and the exclusions too few. The proposal therefore deserved serious consideration. He himself supported it, on the whole, although he would wish to make detailed comments on the merits of individual items. He also favoured allocating the first part to draft article 6 and the second to draft article 4.

22. Mr. FERRARI (Italy) agreed that the proposal should be considered on its merits; it was, after all, the product of consultations with the banking industry. Equally, however, in common with others, his delegation felt obliged to solicit the reaction of professionals in his own country before making any final decision; and he would dismiss out of hand some of the proposal's provisions.

23. Mr. DUCAROIR (Observer for the European Banking Federation) fully acknowledged the importance for delegations of consulting banking professionals in their own countries. He noted, however, that his Federation's proposal had benefited from consultations with banking representatives not only from Europe but also from the United States and other countries, as the endorsement by the Financial Markets Lawyers Group contained in document A/CN.9/472/Add.1 showed. The International Swaps and Derivatives Association had also expressed support. In other words, his Federation had ensured broad acceptance of its ideas before submitting its proposal.

24. Mr. KUHN (Observer for Switzerland) said that the Commission should disregard the timeliness or otherwise of the proposal and concentrate on its substance, which raised valid concerns. He had doubts about some aspects of the proposal, but the Commission could afford to devote some time to discussing it.

25. Mr. AL-ZAID (Observer for Kuwait) expressed broad support for the proposal, particularly because its scope extended beyond banking to industrial and intellectual property. It was not perfect, however. He feared that its adoption might require an amendment of draft article 5 and further attention from the Working Group, if the draft Convention was to be universally acceptable. Delegations should, therefore, be given the opportunity to engage in consultations in their home countries.

26. Mr. PICKEL (Observer for the International Swaps and Derivatives Association) emphasized the importance of ensuring that the scope of the draft Convention was satisfactory. His Association had expressed a written preference for variant B, as amended by the European Banking Federation. Variants A and B both had flaws: in particular, they made a distinction between trade and financial receivables, which would undoubtedly give rise to problems of definition, in addition to the weaknesses noted by the representative of Japan. His Association favoured, however, the exclusion approach, even if the broad definition of the word "receivable" was adopted: the banks in Europe, which were among the Association's members in 37 countries, had been active in developing the standards whereby contracts were concluded and they were satisfied with the way they functioned. They would not welcome intervention from the draft Convention. For that reason, he was in favour of providing for the exclusion of financial netting contracts.

27. Mr. SALINGER (Observer for Factors Chain International) said that, if delegations consulted factors and invoice discounters as well as banking and financial practitioners, and if they envisaged the draft Convention lasting more than a few years, they would realize that any inclusive list would cause severe difficulties. Some kinds of receivable existed that even three or four years previously would not have been thought suitable for factoring. A similar process was bound to occur over the next few years, with new kinds of receivable emerging. A list of exclusions, on the other hand, was acceptable, for example to meet the concerns of those who felt that draft article 11 would destroy existing arrangements for swaps and derivatives.

28. Ms. WALSH (Observer for Canada) said that, as previously stated, the issues addressed by the proposal had first been brought before the Working Group, which had not been able to resolve the problems satisfactorily. As a result, it had fallen to the full Commission to consider the matter. She could not accept all the details relating to exclusion and inclusion, but she believed that the proposal should be addressed on its merits.

29. Ms. MANGKLATAKUL (Thailand) said that, although the lists would be useful for her country, a relative newcomer to international banking, the scope and applicability of the draft Convention should be as broad as possible. There was a danger that, while countries were preparing to accede, changes might take place that would invalidate the lists.

30. Ms. POSTELNICESCU (Romania) concurred with those who had pointed to the dangers of limitations; there was no knowing what receivables might emerge over the next few years. On the other hand, she welcomed the detail in which the proposal had been drafted, as a result of which it would be easier to enforce the draft Convention.

31. The CHAIRMAN noted that the proposal enjoyed general support, although some feared that the Commission's work would be hampered by the need for delegations to engage in consultations. The main issue was whether the exhaustive list of receivables contained in the first part was desirable. Many speakers had also expressed the view that more time was needed to consider the exclusion list. He suggested that the meeting should be suspended while informal consultations took place.

The meeting was suspended at 11.15 a.m. and resumed at 11.50 a.m.

32. Mr. SMITH (United States of America) suggested that the Commission should first consider the proposed list of exclusions from the draft Convention, in article 6 (x) (ii) of his delegation's proposal in document A/CN.9/XXXIII/CRP.4. It could then look at rights to payment that would be covered by the draft Convention, and determine whether there could be a general formulation of those rights.

33. His delegation proposed that rights to payment arising from transactions on a regulated futures exchange should be excluded from the Convention, because rights to payment arising from the sale of crops or other farm products and other commodities were often traded on exchanges that were regulated by local governments through special brokers licensed by local governments. If the draft Convention were to apply to those rights to payment, it would be possible for someone who traded a commodity future and had a right to payment through a broker to assign that right so that the broker would have to make the payment to the assignee in order to receive a discharge; that would create a choice of law situation in respect of the assignor's jurisdiction and would eliminate the broker's right of set-off under other laws, and might create a situation in which an assignment was effective notwithstanding an agreement between the broker and the assignor that the assignor would not assign the right to payment. His delegation therefore felt that the draft Convention rules might not be well suited to that highly regulated industry, which involved sophisticated parties and in which there was no need for the financing that the draft Convention would permit.

34. The CHAIRMAN asked whether the exclusion was meant to apply only to regulated commodities and futures exchanges, or would apply to all future exchanges.

35. Mr. SMITH (United States of America) said that his delegation had intended that the exclusion would apply only in situations where the exchange was regulated by exchange rules under government supervision. The idea was to distinguish between private party sales and sales between parties which were members of an exchange or had accounts with members of an exchange.

36. Mr. WHITELEY (United Kingdom) said that his delegation believed that the exception should be extended to all exchanges, not just derivatives exchanges. There was a degree of consolidation in stock and futures exchanges and in some cases it might be impossible to distinguish between a derivatives exchange and a cash market. One justification for the exemption was that the rules of exchanges in many jurisdictions, including the United Kingdom, were given priority over other laws by specific statutory legislation; his delegation therefore felt that it would be inappropriate for the draft Convention to apply in those circumstances.

37. Mr. SMITH (United States of America) said that article 6 (x) (ii) (I) referred to securities sold on exchanges. The point made by the representative of the United Kingdom could be considered in the context of a more general formulation. His delegation would support such a formulation, covering the items on the list it had prepared, if that language achieved the same objective.

38. The CHAIRMAN suggested that the Commission should proceed to a general consideration of other items on the list of possible exclusions, and revert to each item later in order to give policy directions to the Working Group.

39. Mr. SMITH (United States of America) said that the items in article 6 (x) (ii) (B) (rights to payment arising from the sale, lease or loan of gold or other precious metals) and (H) (rights to payment arising from foreign exchange contracts) could be considered together, because gold and other precious metals were treated on exchanges very much like currency.

40. Mr. SCHNEIDER (Germany) said that trading in gold and other precious metals was largely covered by the reference to regulated futures exchanges. Item (B) might not be necessary.

41. Mr. SMITH (United States of America) agreed that there was an overlap between (A) and (B). However, that overlap existed only to the extent that precious metals were traded on a regulated exchange. In the precious metals market, private parties often traded in precious metals and foreign exchange without participating in a regulated exchange, often through banks or other intermediaries under industry netting agreements. Even if most foreign exchange and precious metals transactions were covered under the exclusions relating to regulated futures exchanges and financial netting agreements, there was always a possibility of private parties trading without the use of netting agreements, where an exception would be in order.

42. Mr. SCHNEIDER (Germany) said that he had difficulty with the idea of excluding private transactions in gold and precious metals, such as professional trading in gold for jewellery. His delegation felt that it would be sufficient to refer to regulated exchange trading, which would include foreign exchange, gold and precious metals.

43. Mr. WHITELEY (United Kingdom) said that, in some jurisdictions, the government controlled transfers of currency, and

those controls could include controls on the transfer of precious metals either within the jurisdiction or from the territory of the jurisdiction to off-shore parties. His delegation believed that, if the draft Convention was to retain its appeal, an exception might be appropriate. His Government had specific concerns about gold held by the central bank, whether on an allocated or an unallocated basis; it would not want the Bank of England to be required to determine priority rules for gold in accordance with an offshore jurisdiction if the assignor were outside the United Kingdom.

44. Mr. STOUFFLET (France) said that his delegation agreed with the delegation of Germany that it would not be wise to decide that a receivable was excluded from the scope of the draft Convention simply because of the nature of the object which gave rise to the receivable; it was the method of settlement which justified an exclusion. In the case of gold, either the transaction was made on a regulated market, in which case the exception in (A) was justified, or the operation was part of a netting agreement between the buyer and the seller, in which case the exception in (C) could apply. However. as had been pointed out, gold could also be sold in an isolated operation, as in the case of industrial gold; and there was no reason why the fact that a receivable derived from the sale of gold or other precious metals should be a ground for excluding it from the application of the draft Convention. Furthermore, it was not clear at what point a metal was no longer a precious metal.

45. Mr. SALINGER (Observer for Factors Chain International) said that he supported the view expressed by the representative of France. Moreover, gold, silver and precious metals were often the subject of factoring arrangements, for example in sales to jewellers, and it was the nature of the transaction rather than the nature of the underlying commodity that was important. There would also be complications with regard to alloys.

46. Mr. DOYLE (Observer for Ireland) said that he also supported the points made by the representative of France. Moreover, exception (B) could set back the Commission's work. He recalled that the Commission had started out with a detailed list of exclusions and had taken a decision to limit exclusions to receivables of a domestic nature or receivables which were already sufficiently regulated. He did not feel that item (B) fell into either category, and was concerned that an exception of that nature might open the door to other equally detailed and specific exceptions, which would be contrary to the decision taken on the scope of the definition of a receivable.

47. Ms. CHUNG (Observer for the Republic of Korea) said that her delegation aligned itself with the comments made by the representative of France. The criterion for exclusions from the scope of the draft Convention should be whether there was a unique industrial practice, or payment technique, not the content of the transaction. The issue also arose in relation to payments under foreign exchange contracts.

48. Mr. SMITH (United States of America) said, with regard to exclusion (C) (rights to payment under a financial netting agreement), that a netting agreement represented an overall relationship between two parties which entered into numerous transactions and, when that relationship was terminated, combined all credits and debits to create one sum owed by one of the parties to the other party. Those contracts were made among sophisticated parties, using industry-tailored agreements designed to facilitate the many transactions between the two parties, and his delegation did not believe that all aspects of the draft Convention would be applicable to such transactions. It also had concerns about whether an assignment would be effective despite an anti-assignment clause, whether the rights of set-off between the two parties would be preserved, and how the debtor would achieve discharge; moreover, because securities or other rights to payment were often offered as collateral and held in specialized deposit or security accounts, the choice of law rules might not be appropriate. His delegation therefore proposed that netting agreements should be excluded, since those transactions did not require the intervention of the Convention to make possible the extension of credit.

49. Ms. WALSH (Observer for Canada) asked whether the exclusion was intended to cover netting agreements or multilateral netting agreements in non-financial contracts such as netting agreements among airlines or in the farming business.

50. Mr. SMITH (United States of America) said that his delegation had felt that the exclusion should be limited to financial netting contracts; it had no particular view as to whether other netting contracts should be included.

51. Mr. SCHNEIDER (Germany) said that his delegation supported the idea behind the exclusion, and believed that multilateral netting agreements should be excluded. However, it was not clear whether exclusion (C) referred only to the type of receivables that existed after netting agreements were concluded, or referred also to receivables which went into netting agreements.

52. Mr. DUCAROIR (Observer for the European Banking Federation) wondered whether exclusions (C) and (I) could be combined in a single provision. The practice of netting as covered in (C) was very often accessory to a financial contract, for example loans of securities or pensions based on securities, which came under paragraph (I), and also swaps and derivatives. The Federation provided a list of such transactions in its own proposal, contained in document A/CN.9/472/Add.1, and attempted to define the term "financial contract".

53. Mr. DOYLE (Observer for Ireland) supported exclusion (C), the only problem being one of definition. As the United States delegation seemed to agree with the definitions provided by EBF in document A/CN.9/472/Add.1, perhaps that text could be the basis for drafting definitions of "financial contract" and "netting agreement".

54. Mr. PICKEL (Observer for the International Swaps and Derivatives Association) noted that definitions could be useful. He believed that the concept of a financial netting agreement covered transactions such as those carried out under the master agreement published by his organization. The representative of Germany had been correct in his comment that, under the relationship document, payments flowed back and forth between the parties in various transactions over time and were in that sense receivables from one party to the other. They might be subject to netting on a payment basis but, once that relationship was terminated, a single sum was determined as owing from one party to the other, which according to his organization's contract was assignable by the party who was entitled to receive that payment as security or otherwise.

55. Mr. WHITELEY (United Kingdom) supported the exclusion.

56. Mr. DESCHAMPS (Observer for Canada) said that the Commission should consider whether the exclusion or special treatment of netting agreements should include netting agreements in non-financial contracts. It had not yet been decided whether the protection should be obtained through complete exclusion or through variant B.

57. Exclusion (C) referred only to netting agreements relating to financial contracts. The German delegation had raised the policy issue of protection for netting agreements in financial contracts but not in other kinds of contracts. However, from a policy standpoint, business concerns such as airlines would also be justified in requesting similar protection, and then the text would exclude a number of trade receivables that the Commission would not necessarily want to exclude. As a tentative solution, he would propose that the matter be dealt with in article 5, concerning anti-assignment clauses, preferably in variant B.

58. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the Commission might wish to decide whether netting arrangements in general should be treated through an article 11 and 12 approach. Alternatively, netting arrangements in financial contracts could be treated through an article 4 approach, meaning total exclusion from the draft Convention, while netting arrangements in other contracts could be dealt with by an article 11 and 12 exclusion.

59. Mr. SMITH (United States of America) said that there was no reason why the Convention in its entirety should not apply to the payment owed by one party to the other, once the relationship was terminated and the debits and credits were combined to determine the single sum owing. If non-financial netting contracts were to be generally excluded, as well as financial netting contracts, in both cases the so-called “close-out payment” should be covered by the Convention.

60. The exclusion of netting contracts, whether financial or non-financial, from articles 11 and 12 only, did not seem likely to work. The industry experts consulted by his delegation had explained that, if the assignment between the assignor and the assignee was effective under national law despite the anti-assignment clause, and there was a breach of contract, the debtor might lose the mutuality that was necessary for preserving its right of set-off for transactions that were currently occurring or would shortly occur under their master contracts. For that reason, prior to close-out, the draft Convention should not apply to debits and credits between the parties; upon close-out, it would apply to the single sum owed by one party to the other.

61. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices), pointed out that the difficulty just mentioned by the United States representative concerning the lack of protection for the parties to a netting agreement would also arise if the Commission adopted an article 4 approach. Whether the Commission adopted an article 4 approach, or an exclusion from the assignment clause provisions of articles 11 and 12, national law would apply in both cases. The draft Convention could do nothing to protect the parties to the netting agreement against any risk involved. However, those parties could protect themselves through their own mechanisms and choice of laws and other appropriate solutions under their contractual arrangements.

62. Mr. MORÁN BOVIO (Spain) emphasized that the Commission did not seek to affect well-established general practices that were functioning well in the world at the present time. Yet the United States proposal would exclude some well-established practices, for example in the precious metals and other similar markets, because the subject of the transaction was being identified with the form of the transaction, to the extent that they could not be separated. It seemed that the same thing happened in markets that functioned under netting agreements. The Commission was not concerned with what happened during the netting itself, but could be interested in what happened with the resulting amount, and whether or not the draft Convention applied.

63. Exclusion under article 4 would be more appropriate in some cases, including in connection with netting agreements, in order to avoid distortion of well-established practices.

64. Mr. PICKEL (Observer for the International Swaps and Derivatives Association) said that an article 4 exclusion would take into account the fact that parties not only had master agreements in place to govern their relationships but typically would also have security arrangements, which would present a series of priority considerations. On behalf of its members, the International Swaps and Derivatives Association had obtained opinions in a number of jurisdictions on the enforceability of the master agreement as well as the enforceability and choice of law issues relating to collateral arrangements using documents sponsored by it. Its members had looked very carefully at a number of issues and had satisfied themselves as to their course of action.

65. The Commission should agree that certain types of netting agreements, for example between airlines, should be excluded. However, a general reference to netting agreements would mean that various transactions such as sales of goods or other things that should be governed by the draft Convention could be put under some kind of netting agreement and thus excluded from the draft Convention.

66. The financial netting agreement was an appropriate designation for the types of contract that should be excluded and he believed that an article 4 exclusion was more appropriate.

67. Mr. SCHNEIDER (Germany) said that there were different types of netting agreements, not only between banks and financial institutions, but also between other parties in industries such as industrial clearing, the transport industry, railways, and air traffic. The question was whether to have the same rule for all types of netting agreements or to have a separate rule only for financial institutions. In general, it would seem preferable to have the same rule. The main problem was anti-assignment clauses. In general he preferred an article 11 rather than an article 4 approach. However, a special case should be made for financial contracts, because other problems might arise in the case of financial contracts and netting agreements with receivables stemming from financial contracts. He therefore favoured an article 4 approach for financial contracts, and an article 11 approach for other types of netting agreement, such as industrial netting agreements.

68. Mr. DOYLE (Observer for Ireland) favoured an article 11 approach for netting agreements. There would thus be a very short list of article 4 exclusions which were outside the Convention altogether, and a rather longer and more elaborate list of provisions under article 11 which would be excluded from articles 11 and 12, but would enjoy the general benefits of the draft Convention. It had been his impression that netting agreements were to fall in the latter category.

The meeting rose at 1 p.m.

Summary record of the 681st Meeting

Wednesday, 14 June 2000, at 3 p.m.

[A/CN.9/SR.681]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 3.05 p.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXIII/CRP.4)

1. The CHAIRMAN reviewed the issues still to be decided in connection with the United States proposed revision of article 6 of the draft Convention (A/CN.9/XXXIII/CRP.4): the merging of subparagraphs (ii) (C) and (I), as proposed by the European Banking Federation (EBF); the exclusion of non-financial receivables in subparagraph (ii), for which there was general support; the question as to whether all or some receivables should be excluded and whether that should be done within the scope of provisions or under the anti-assignment clauses of article 11; the need for a definition of the term "netting", and the inclusion of close-out payments, for which there was strong support.

2. Mr. COHEN (United States of America) observed that, while on three of the four issues something close to a consensus was emerging, there was disagreement as to whether to approach some issues as a matter of exclusion or as a matter of exception. The United States favoured exclusion. If applicable domestic law fully enforced an anti-assignment clause in an agreement between parties under article 11 of the draft Convention, then there was no problem. The problem arose when applicable law either did not enforce such a clause or made the assignment effective between the assignor and the assignee and perhaps created action for breach, the trouble then being that many Convention rules were not suited to cover such assignment. Four main sets of rules that would be unsuitable were those regarding warranties and representations on assignment, debt protection, set-offs, and especially the choice-of-law rules in article 24 for priority matters. Given the variety of domestic laws, the United States delegation was concerned that producing a Convention that might apply to such matters was a dangerous solution and therefore favoured their exclusion from the scope of the draft Convention.

3. The CHAIRMAN asked whether the United States representative had all netting transactions in mind or just financial ones.

4. Mr. COHEN (United States of America) said that he certainly had financial netting in mind but would have to think further about whether the rule in question should be extended to cover non-financial netting.

5. The CHAIRMAN said he took it that there was consensus that subparagraphs (ii) (C) and (I) should be merged, as suggested by the European Banking Federation, and should be referred to the Drafting Group. More thought had to be given to the exclusion of non-financial receivables.

6. *It was so decided.*

7. The CHAIRMAN invited the Commission to consider whether a definition was needed of the term "netting agreement" and to comment on the definition proposed by the European Banking Federation (A/CN.9/472/Add.1, p. 12, subparagraph *(o)*).

8. Mr. BERNER (Observer for the Association of the Bar of the City of New York), said that the EBF text was an excellent basis for discussion. However, a synonym should be found for the term "set-off" used in subparagraph *(o) (c)*, as its history made it inappropriate for use in the draft Convention.

9. Mr. COHEN (United States of America), agreeing that the EBF text could serve as a good working basis, suggested that delegations and observers should submit adjustments to the Drafting Group, which could prepare a revised text for further consideration.

10. The CHAIRMAN said that all the concerns expressed thus far, not excluding close-out payments, would have to be incorporated.

11. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) cautioned that the Drafting Group could establish language versions of a text agreed upon by the Commission but could not prepare language on matters not yet decided as to policy.

12. Mr. COHEN (United States of America) suggested that under the circumstances further ad hoc consultations should be held among delegations.

13. The CHAIRMAN, concurring, suggested that every member of the Commission should review the list of receivables and convey their ideas to an ad hoc drafting group of delegations, which would report back to the Commission with new language for its consideration.

14. Mr. SCHNEIDER (Germany) said that his delegation had problems with the EBF definition of a netting agreement. For instance, if a netting agreement was an agreement which provided for "one or more" of the three operations listed, that would mean that termination because of insolvency as set out in subparagraph *(b)* must in itself be considered a netting agreement, which was unacceptable.

15. Mr. DUCAROIR (Observer for the European Banking Federation (EBF)) asked for clarification as to whether subparagraph (ii) (C) of the United States proposal was in fact being extended to include non-financial receivables. If so, his Federation's proposal to merge subparagraph (ii) (C) and subparagraph (ii) (I) would be withdrawn.

16. Mr. DESCHAMPS (Observer for Canada) said he did not think that subparagraph (ii) (C), which was an exclusion, should be extended to cover non-financial receivables. If the draft Convention excluded non-financial contracts subject to netting agreements, the result would be a very broad and ill-defined exclusion. Trade receivables subject to netting agreements might, however, need some protection and should be dealt with under either article 11 regarding contractual limitations on assignments or articles 20 and 21 regarding debtor's defences.

17. Mr. MORÁN BOVIO (Spain) said that he fully supported the proposed EBF definition of netting agreements, including the condition that "one or more" of the three operations indicated should be provided for, an occurrence that was very frequent in practice, especially in complex netting agreements. The advantage of the EBF definition in subparagraph *(o)* was that its sharp focus clarified subparagraph (ii) (C) of the United States proposal.

18. Mr. SALINGER (Observer for Factors Chain International) said that he was puzzled by the EBF definition. He thought of a netting agreement as an agreement in the air transport field, say, where large numbers of traders pooled their debits and credits and the one with the net credit drew from the pool. The EBF text, however, conceived of just two traders, a situation which would surely exclude a great many transactions with set-off agreements.

19. Mr. PICKEL (Observer for the International Swaps and Derivatives Association (ISDA)) said that the EBF definition contained all the essential elements of what he considered to be a netting agreement. It was true that such agreements were often multilateral; but in the financial markets they tended to be bilateral, while still covering many different transactions and the various cash flows involved, all of them typically subject to netting on payment dates and again upon termination of the relationship.

20. The CHAIRMAN invited the United States delegation to comment on subparagraph (ii) (D) of his proposed redrafting of article 6.

21. Mr. COHEN (United States of America) said that the Commission should be wary about proposing rules that would interfere with the very specialized arrangements involved in bank deposits and inter-bank payments, which were working well in the absence of a convention. Under any definition of a receivable, every bank deposit created a receivable, where the debtor was the bank and the creditor, which might become the assignor, was the depositor. The rules of the draft Convention barely applied to such a receivable, even with regard to location. That was true for any deposit, but especially so for inter-bank payment systems, which in many States operated through mutual accounts maintained between banks. Subparagraph (ii) (D) would exclude both types of receivables.

22. Mr. DUCAROIR (Observer for the European Banking Federation (EBF)) said that there were two distinct categories of receivables included under the same heading in subparagraph (ii) (D). It was important to classify operations clearly and separately, according to their nature. The Federation also believed that, in addition to the inter-bank payment systems, which involved cash, the exclusion should cover securities settlement systems as well, namely, the final cash settlement between financial intermediaries of stock exchange operations. Such receivables were in an entirely different category from the receivables addressed in subparagraph (ii) (I) of the United States text and were not dealt with anywhere in the United States proposal.

23. Mr. WHITELEY (United Kingdom) also favoured excluding inter-bank relationships.

24. Mr. STOUFFLET (France) agreed with the observer for the European Banking Federation that it was undesirable to include under the same heading rights to payment under bank deposit relationships and under inter-bank payment systems. He would support the exclusion of inter-bank relationships, which was justified for the same reason as the exclusion of netting agreements. If subparagraph (D) was intended to cover bank accounts, it should be understood that a bank account was a financial instrument which registered receivables as between a bank and its clients. It was appropriate to exclude bank accounts if the intent was to avoid perturbing the draft Convention. However, from a legal point of view there was no reason why bank deposits should not be treated as receivables subject to assignment, provided that the criteria for assignability were fulfilled.

25. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said it could be assumed, from the remarks of the observer for the European Banking Federation, that there was an intention to merge the rights specified in subparagraph (x) (ii) (C), (D) and (I). He was not sure whether, following the approach of the representative of France, deposit accounts would necessarily be excluded from the scope of the draft Convention. If such was not the case, it was important to know whether it was proposed to include them without special treatment or to treat them differently with respect to assignment agreements. A bank faced with an unknown creditor under an assignment agreement might encounter difficulty in meeting the requirements of money-laundering legislation. To avoid that situation, the suggestion by the observer for the European Banking Federation would involve incorporating language to identify the assignee. Another concern for debtor banks was the potential conflict of priority among deposit accounts, which under the law of some countries was governed by the location of the debtor, not the assignor.

26. Mr. DOYLE (Observer for Ireland) said that subparagraph (C) dealt with different concepts which should not be merged. He did not object to the exclusion of inter-bank relationships, but shared the misgivings of the representative of France concerning the exclusion of bank deposits. A conscious decision had already been made, following discussion, that they should not be excluded from the scope of draft article 4, but should be excluded from draft articles 11 and 12. There was no reason to reverse that decision.

27. Mr. WHITELEY (United Kingdom) emphasized that if deposit accounts were retained within the scope of the Convention the priority rules of the Convention would be incompatible with United Kingdom law and that of other jurisdictions. He hoped they could be amended in that respect.

28. Mr. COHEN (United States of America) remarked that, if the Commission adhered to the decision mentioned by the observer for Ireland, it had a duty to ensure that the Convention rules would work properly for the receivable concerned. Many of the banks affected believed that neither the priority rules of draft article 24 nor the location rules worked for bank deposit relationships. If they were included within the scope of the draft Convention, great care would have to be taken to avoid harming their operation, and it would be difficult to decide which Convention rules needed adjustment. It seemed better to exclude bank deposit relationships altogether.

29. Mr. MORÁN BOVIO (Spain) pointed out that when a bank accepted a deposit, in most cases the purpose of the depositor, in the case of a business, was to use it as a guarantee or support for other transactions with the bank. The banking community would not look favourably on a convention which permitted such receivables to be readily assigned, because in that case the banks would find themselves without a sufficient guarantee for the assets concerned. He was in favour of excluding from the scope of the draft Convention both kinds of rights mentioned in subparagraph (D).

30. Mr. DUCAROIR (Observer for the European Banking Federation (EBF)) said that the Working Group had not formally agreed to exclude either kind. One of the aims of the draft Con-

vention was to facilitate the flow of credit by enhancing the predictability and security of credit provision. Care should be taken to avoid defeating that aim.

31. Mr. STOUFFLET (France) pointed out that the lawfulness of bank deposit relationships was not in question; it was common practice to assign receivables arising from bank deposits, and there was no international-law prohibition against doing so. The only question to be decided was whether such operations should be governed by the draft Convention.

32. Mr. DUCAROIR (Observer for the European Banking Federation (EBF)) emphasized that he was not seeking to remove bank deposit relationships altogether but only to exclude them from the scope of draft articles 11 and 12.

33. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) asked whether, in the Commission's view, the inclusion of bank deposit accounts would require adjustment of some provisions of the draft Convention. Would some difference of treatment be needed in draft article 11, and would the provisions concerning identification of the assignee, money-laundering, set-off and priority have to be adjusted"

34. Mr. SCHNEIDER (Germany) agreed with the representative of France that bank deposits should be included within the scope of the draft Convention. There would be no need to amend the existing text for that purpose, since money-laundering was already covered by the identification requirements of special and contract law. The laws on money-laundering did not in themselves prevent any kind of assignment. Anti-assignment agreements should be dealt with in the context of draft article 11.

35. Mr. MORÁN BOVIO (Spain), said that if deposit accounts were included some aspects of the draft Convention would indeed be affected, specifically the question of the applicable law in the case of an assignor in a non-contracting State. That issue would arise if a client of a credit institution deposited a large sum in a bank and assigned the credit to the bank to recover. In such a case, the normal relationship would be reversed, the assignor being the client rather than the bank. That hypothesis had to be considered because under the law of many countries, the forum was the State where the credit institution was located.

36. Mr. COHEN (United States of America) agreed with the representative of Spain that many issues would have to be considered if the bank deposit relationships were covered. To prevent any harm arising from the Convention, every draft article would have to be re-examined to ascertain whether it would work for bank deposits.

37. The CHAIRMAN said that in deciding whether to include or exclude bank deposits, the Commission also had to ascertain whether the core provisions of the draft Convention needed re-examination. A third option would be to include bank deposits but to exclude them from the operation of the anti-assignment clauses.

38. Mr. DOYLE (Observer for Ireland) was convinced that the previous decision of the Working Group had been wrong: bank deposits should have been excluded.

39. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) said that the Working Group had reached its decision because there was a general desire to produce a convention with a very broad scope, but it was now apparent that the decision would generate too many problems. One of the aims of the draft Convention was to make credit available at lower cost. Bank deposit transactions were now proceeding smoothly enough, and from a business point of view there was no advantage in incorporating them within the scope of the draft Convention. Nor were bank clients, in general, seeking to assign their accounts.

40. The CHAIRMAN said he concluded that the Commission had reached a consensus to exclude bank deposits from the scope of the draft Convention. Rights to payment under inter-bank payment systems would be considered in conjunction with subparagraphs (C) and (I). The Commission should therefore turn to the proposed exclusion, in subparagraph (E), of rights to payment from an insurer under an insurance contract, or from a reinsurer under a reinsurance contract.

41. Mr. COHEN (United States of America) explained that the proposal to exclude those rights derived from the fact that the securities, banking and insurance industries and their respective services were tending to merge and therefore required similar treatment. The insurance industry was highly regulated and created settled expectations, which would be disrupted if the Convention were applied to it.

42. Mr. SCHNEIDER (Germany) disagreed. He had never encountered problems in banking supervision law which would be exacerbated by the Convention rules. He felt the draft Convention should not be unduly watered down by repeated exclusions, nor should rules be devised which would be detrimental to those wishing to assign rights stemming from insurance contracts. In Europe, cross-border transactions were frequent, and extra cost and inconvenience would arise if domestic law continued to apply to assignment as in the past.

43. Mr. STOUFFLET (France) took the same view. Credits arising from insurance contracts were common, and losses would be incurred if they could not be assigned to banks. The Commission should have more confidence in the draft Convention.

44. Mr. MORÁN BOVIO (Spain) agreed that exclusion would pose difficulties. It was not clear, however, from the wording of the subparagraph who the assignor would be in such cases: would it be the insurance company holding credit rights vis-à-vis its clients? In that case, exclusion would be problematic.

45. Mr. DESCHAMPS (Observer for Canada) asked whether the term "insurance contract" was intended to cover annuity contracts, which in Canada were often equated with insurance contracts and performed functions akin to bank deposits. He felt that existing practices which worked well should not be interfered with. Lenders and debtors should not be subjected to Convention rules against their will; the Commission should decide on rules to govern their practices only if one side wanted them. In the case of insurance, however, it was not clear that the draft Convention would disturb an existing practice which was working well from the lender's viewpoint. He did not entirely favour exclusion but would prefer a more limited type of exclusion, of the type envisaged in draft article 9.

46. Mr. WHITELEY (United Kingdom) said it was important for the Commission to look at the risks covered by insurance policies. If an insured person who was covered against risk of loss assigned the asset causing the loss, it might be appropriate for both the policy and the loss to be assigned, since the benefit of the policy would accrue to the person suffering the loss. However, it would be inappropriate for one party to be able to purchase protection against risk of loss and then assign it to a third party who did not hold the asset and did not suffer the loss. That would also be an odd situation from the viewpoint of the financial markets. As for insurance policies covering events consequent upon a death, there was a public policy restriction in his country against trading life insurance policies.

47. Mr. SALINGER (Observer for Factors Chain International (FCI)) said that factors and invoice discounters could be affected by the exclusion proposed in subparagraph (E). Some surprising new forms of contract were now being factored: one recent development was factoring services for clinics in holiday resorts to finance claims assigned to them by patients against insurance companies overseas. In most European and Far Eastern countries, the benefits of insurance policies could now be assigned to the factor, by virtue of a practice whereby factoring was provided with recourse, on the back of a credit insurance policy issued to the client. It would be useful for the factors providing such services to be accorded international recognition.

48. Mr. BURMAN (United States of America) said that at least five different types of insurance had been discussed, namely, casualty insurance, liability insurance, life insurance, annuities and credit insurance. Perhaps the only thing they had in common was the word "insurance". Different public policies governed different types of insurance. There were different considerations as to whether the rules under the draft Convention applied to an assignment. His delegation feared that if rights to payment from an insurer were not excluded, it would be necessary to test the Convention rules for each type of insurance. The purpose of the tests would be to ensure that the draft Convention did not harm any industries which had the word insurance in their names.

49. The Commission's time was limited. In order not to interfere with well-settled markets, the most prudent course was to refrain from having the draft Convention govern assignments with respect to insurance policies.

50. Mr. SCHNEIDER (Germany) said that it was important to preserve the possibility of making cross-border assignments of receivables stemming from insurance contracts. He questioned the need to distinguish among different types of insurance. Such distinctions were not made with regard to sales contracts.

51. The CHAIRMAN said that the United States delegation had explained that its proposal was necessary partly for reasons of consistency and partly to cater for an ever-growing field which was already well regulated. However, he did not see much support for the proposal.

The meeting was suspended at 4.40 p.m. and resumed at 5.10 p.m.

52. Mr. BURMAN (United States of America), replying to the representative of Germany, said that there was a difference between insurance and reinsurance. In its contacts with insurance and reinsurance companies, his delegation had heard consistent expressions of significant concern from companies in several lines of insurance and reinsurance.

53. The insurance industry was heavily regulated in most countries. There were specific standards and rules by which its accounts were assessed. Assignments played a role in that assessment. In the reinsurance industry, there was a network of protocols governing the interrelationship between reinsurance participants and the insurance companies that dealt directly with the policies and services which they provided. In neither case had the industry sought coverage under the draft Convention, nor would such coverage be welcomed by either industry. If the current viewpoint was maintained, the Commission would have created for itself a problem that it would regret.

54. His delegation was not talking about excluding a certain kind of assignment. There was a limited but definite market in the assignment of some types of claims under certain kinds of insurance. He questioned, however, whether it was appropriate to seek to have that market covered by draft Convention rules, which in large measure were designed for trade receivables. His delegation recommended that the Commission should not take that risk, as the amount of business which it would cover would not be commensurate with the degree of risk that it would incur if the industry engaged in organized opposition to the final text.

55. The CHAIRMAN said that the United States proposal reflected a concern expressed by its insurance industry, whereas other delegations had expressed opposite concerns. The matter must be resolved.

56. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) said it was important for factors that claims against insurance companies should be included in the Convention. The observer for FCI had explained why that was so. The representative of the United Kingdom had pointed out that assets might be assigned to a third party. The insurance covering those assets was also assigned to a third party. That was exactly what happened in factoring transactions. The factor not only acquired the receivable against the debtor; the factor also took title in the goods to be delivered and was assigned the proper insurance covering those goods for loss or damage in transport. In order to have those transactions ruled by a single law, it would be appropriate to have claims against insurance companies included in the draft Convention. Otherwise, the factor would need to establish the assignment of the receivable according to the law of the Convention and to look into the law governing assignment of the insurance. Accordingly, if the Commission wished to avoid harming any existing business practices, it should also examine the business practices of the factoring industry, not only those of the insurance companies.

57. Mr. BURMAN (United States of America) said that the application of the Convention would be helpful to the factoring industry in respect of certain types of insurance. He wondered whether it would be helpful to the Commission to recognize the distinction between life insurance and annuity insurance and all other types of insurance. Perhaps the exclusion should be limited to those types of insurance policies that were actually investment vehicles.

58. The CHAIRMAN said that possibility had been mooted earlier; however, he did not recall any comments having been made on it.

59. Mr. RENGER (Germany) urged the Commission to begin discussing which claims out of which contracts should be included or excluded. Nothing provided for in the draft Convention would interfere with the regulations applying to insurance companies. What was at issue was payment from an insurer. Thus, the claimant was never an insurance company; it was always another person. He therefore failed to understand why a problem was perceived. If payments from an insurer were excluded, it would be unclear to whom the draft Convention applied. The Commission would be creating loopholes while at the same time believing that it was establishing a uniform law for the international assignment of receivables. While he saw no need for the distinction proposed by the United States delegation, his delegation could accept the exclusion of reinsurance companies.

60. Mr. WHITELEY (United Kingdom), referring to the statements made by the factoring industry representatives, said that, with regard to assignments of rights under insurance contracts, the examples given had focused on situations where the loss had already occurred. What was being assigned was a crystallized right to payment. The reason for the assignment was to short-circuit the settlement procedure. He requested clarification of whether that was the real focus of the industry's concern, or whether it was also interested in ensuring that potential claims

under insurance contracts could be assigned even where the condition for payment had not yet occurred.

61. Mr. SALINGER (Observer for Factors Chain International (FCI)), replying to the United Kingdom representative, said that the second hypothesis was correct. A supplier of goods and services entered into a factoring agreement for the factoring of all the debt that arose from the whole of his business for a minimum of one year. As one of the conditions of the factoring agreement, he must have issued to him a policy of credit insurance, all the benefits and rights of which were to be assigned to the factor. There might never be a claim under that insurance policy. If there was a bad debt, however, the insurance company would pay the factor directly. Having already paid a substantial part of the debt to the client, and having been paid by the insurance company, the factor would not need to recost the debt.

62. Mr. DOYLE (Observer for Ireland), supporting the statement made by the representative of Germany, said that there was a danger in making too many exceptions. It was clear that there was a good reason for excluding banking deposits, namely, that it would be difficult, if not impossible, to apply the Convention to them. That did not appear to be the ground for the exclusion of insurance contracts, mainly because the industry did not wish to have them included.

63. The CHAIRMAN said that the United States proposal to exclude rights to payment under insurance and reinsurance contracts had failed to elicit a consensus. The Commission would have an opportunity to revisit all the provisions once a working draft had been prepared. In the meantime, it should turn to subparagraph (ii) (F).

64. Mr. COHEN (United States of America) explained that the exclusion proposed by his delegation in subparagraph (ii) (F) concerned rights to payment for goods sold or leased to the extent that under the law of the State where the goods were located the goods were considered to be part of the real estate on which the goods were situated. The rules governing interests in real estate and payments flowing from real estate, such as rents and lease payments, were very local in nature and often highly prized by local jurisdictions. If the draft Convention applied to such receivables, conflicts could arise between the right to the receivable and the right to the real estate. The possible complications were not justified by the commercial utility of including such receivables.

65. Mr. FERRARI (Italy) said that his delegation saw no reason for the exclusion.

66. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) suggested that the intent of the exclusion might be served simply by referring to rights to payment arising from the sale or lease of real estate. If, under local law, certain goods became part of real estate, they would also be covered by the formulation.

67. Mr. COHEN (United States of America) said that he found the suggestion helpful and proposed that the Commission should consider it.

68. Mr. FERRARI (Italy) said that his delegation liked the wording just suggested. Under the United States formulation, a prefabricated-garage manufacturer, for example, who wished to make an assignment of receivables would not be covered by the draft Convention.

69. Mr. AL-NASSER (Observer for Saudi Arabia) said that his delegation felt that the exclusion was not needed. It might be appropriate in a model law, but not in a convention. In the interests of promoting international trade, it would be better to omit it.

70. Mr. DOYLE (Observer for Ireland) said that his delegation had supported the United States proposal but was even happier with the language suggested by the Secretary of the Working Group. The strongest concern that had been expressed by industry groups in Ireland had been that the definition of receivables was so wide that it did not clearly exclude interests arising from real property. With the present exclusion, the draft Convention should meet with a better reception in Ireland.

71. Mr. MORÁN BOVIO (Spain) said that he had not discussed the matter with industry groups in Spain, but he was aware that many real-estate companies depended for their financing on the assignment of their receivables from the sale of lots or lease of premises. Although he saw no strong reason in support of the exclusion, if it found favour with those who foresaw problems with local real estate law, he would prefer the secretariat reformulation.

72. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) said that, although his group naturally had no strong opinions on the advisability of excluding receivables arising from the sale or lease of real estate, it was very concerned that the exclusion should not be worded so broadly that it would exclude from the draft Convention the factoring of goods that would in the future become fixtures of a building, in other words, the whole range of construction materials. The ultimate legal fate of the materials should not affect the factoring agreement.

73. Mr. WHITELEY (United Kingdom) said that his delegation supported the amended wording. Its position was that if the Commission decided against an exclusion of real property interests, the priority rules would have to be changed. Priority with regard to real estate in the United Kingdom was determined by a system of registration, and, should the assignor of the interest be in a different State, the United Kingdom would wish the registration system to prevail.

74. Ms. WALSH (Observer for Canada) said that her delegation agreed that, for the reasons given by Italy and EUROPAFACTORING, the United States wording was unnecessarily broad and would exclude true trade receivables. She would appreciate clarification on the relationship between the new wording proposed by the secretariat and article 12 of the draft Convention, which dealt in part with mortgages. She wondered whether there was a rationale for excluding receivables from the sale or lease of land but not mortgage interest. If, as the statement by the United Kingdom suggested, the main concern was the applicable rule in article 24 of the Convention, complete exclusion would be an inappropriate narrowing of the draft Convention. Perhaps the problem could be solved through a refinement of article 12 or article 24, and a small informal group could work on the problem.

75. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that if the issue was solely that of the law governing priority applicable to receivables arising from the sale and lease of real estate, then there were two possible solutions, as the United Kingdom and Canada had pointed out. Such receivables could be excluded or a different priority rule could be devised for them in article 24 and subsequent relevant articles. In the case of an exclusion, article 12 would no longer apply to security interests in real estate and would have to be amended.

The meeting rose at 6 p.m.

Summary record of the 682nd Meeting

Thursday, 15 June 2000, at 10 a.m.

[A/CN.9/SR.682]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.10 a.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.4)

1. The CHAIRMAN recalled that an ad hoc group on exclusions had been set up to recast the United States proposal concerning article 6, contained in document A/CN.9/XXXIII/CRP.4, in the light of the previous day's discussions. He invited the representative of the United States to report on the group's work.

2. Mr. COHEN (United States of America) said that the ad hoc group, meeting informally, had been able to reach agreement on how many exclusions should be specified in the draft Convention. Before proceeding to the group's recommendations concerning draft article 6 (x) (ii) (A) to (D), he noted that each subparagraph would start with the word "receivables" or the words "rights to payment", depending on whether it was decided to list rights excluded from the definition of "receivable" or receivables the assignment of which was excluded from the scope of the draft Convention. For simplicity's sake he would, in reading out the draft amendments, use the word "receivables". Thus in article 6 (x) (ii) the provision corresponding to subparagraph (A) should read: "Receivables arising from transactions on a regulated exchange". Subparagraph (B) should be deleted and the proposed exclusion in subparagraph (C), should be reworded in the following terms: "Receivables arising under financial contracts governed by netting agreements, except a receivable owed on the termination of all outstanding transactions." In that context, he noted that the terms "financial contract" and "netting agreement" should be defined as proposed by the European Banking Federation (EBF) in document A/CN.9/472/Add.1. The recommendation based on subparagraph (D) aimed at distinguishing between bank deposit relationships and inter-bank payment systems and should read: "Receivables arising under bank deposit relationships," while the next exclusion concerned "Receivables arising under inter-bank payment systems or investment securities settlement systems." No text had been formulated in respect of the exclusions proposed in subparagraphs (F) to (I), in the absence of any guidance from the Commission.

3. With regard to receivables subject to netting agreements but not arising under financial contracts, the group had decided to recommend that assignments of such receivables should not be excluded. The Commission should, however, consider adding a short provision to draft article 20 to accommodate the need for set-off and mutuality in netting systems. Whereas draft article 20 gave debtors certain rights arising from the original contract, the group's proposed provision would enable the debtor, in the case of an assigned receivable subject to a netting agreement, to raise a defence arising from any other contract subject to the same netting agreement. That would preserve the integrity of the netting agreement, even in the event of an assignment of a receivable.

4. The CHAIRMAN suggested that, while delegations considered their positions on exclusions, the Commission should turn to the ad hoc group's suggestion that the netting of non-financial receivables should not be excluded but should be provided for in the set-off provisions of draft article 20. Consideration should also be given to a specific provision enabling a debtor to raise defences which under normal circumstances he would be entitled to raise.

5. Mr. IKEDA (Japan) wondered whether other delegations shared his view that, despite a day of discussion, little headway had been made on the United States proposal, which might yet be rejected in favour of variant A or B of draft article 5. The situation was complicated by the fact that no decision could be reached on the proposal until its effect on other articles could be ascertained. Its merits would have to be weighed against those of variants A and B of draft article 5 and assessed on how it and the two variants affected draft articles 11 and 12, as well as draft articles 6 and 4.

6. Mr. SCHNEIDER (Germany) welcomed the revised text recommended by the ad hoc group, which showed that a major step had been taken towards compromise, particularly if he understood correctly that there was to be no list of inclusions but merely exclusions from a general principle. The changes affecting netting agreements on trade receivables were particularly promising.

7. The CHAIRMAN suggested that, since non-financial receivables were not to be subject to exclusion but would be governed by a provision on debtor set-off and defences that could be raised by the debtor, any discussion of the issue should take place in the context of draft article 20.

8. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that few substantive changes had been made to the text of the United States proposal. In draft article 6 (x) (ii) (A) the only change was the deletion of the word "futures". That made it possible to delete subparagraphs (B) and (H) in their entirety, because subparagraph (A) would cover all regulated exchange transactions. With regard to the second recommendation, the language relating to netting agreements could be refined by the drafting group. The issue of industrial netting should be deferred until draft article 20 was discussed. The third recommendation merged the reference to inter-bank payment systems, as contained in subparagraph (D), with the provisions contained in subparagraph (I), in response to the submission of the European Banking Federation that such transactions should be listed together. That meant that only subparagraphs (F) and (G) remained to be discussed.

9. Mr. DUCAROIR (Observer for the European Banking Federation) welcomed the changes recommended by the ad hoc group, even though they were more editorial than fundamental. For example, the phrase "financial contracts governed by netting agreements" was a substantial improvement on the phrase "financial netting agreement". He wondered, however, what decision the Commission would reach concerning the list of inclusions, which had originally formed part of the United States proposal.

10. The CHAIRMAN took it that inclusions need no longer be considered, or at least not until a final decision on exclusions had been reached.

11. Mr. DESCHAMPS (Observer for Canada) said that the Commission needed to align the French text of subparagraph (ii) (A), as amended in the United States proposal, with the English text. The word "*marché*" did not correspond to the word "exchange". There were many commercial transactions that were carried out in regulated markets.

12. The CHAIRMAN suggested that the Commission should request the drafting group to align the language versions.

13. Mr. STOUFFLET (France) requested clarification about subparagraph (ii) (A), as amended. It was not clear whether it referred to receivables left after the balance of an account had been settled, or receivables which were included in a netting agreement.

14. Mr. MORÁN BOVIO (Spain) agreed that there could be problems with the other language versions of the United States proposal. It might be better to specify whether subparagraph (ii) (A), as amended, referred to an exchange regulated at the international or national level. The Commission needed to know the precise extent of the exclusion in that subparagraph.

15. Mr. DOYLE (Observer for Ireland) recalled that consensus had been reached on the United States proposal in the ad hoc group. Questions of language should be left to the drafting group.

16. The CHAIRMAN said that there seemed to be concern among some delegations that the ambit of the exclusion might be broader than had been intended.

17. Mr. WHITELEY (United Kingdom) said that his delegation agreed that the key issue was regulation, a concept which was usually quite precisely defined in national law. It supported the suggestion made at the previous meeting by the representative of Cameroon that some points could be illustrated in the commentary.

18. Mr. DESCHAMPS (Observer for Canada) said that his delegation did not feel that the problem was merely one of language. The drafting group must be given guidance about what was meant by "exchange". There were regulated markets for farm products; it must be made clear that receivables arising from such transactions would not be covered under the amended subparagraph. The subparagraph should be more precise and refer specifically to the exchange of financial products.

19. The CHAIRMAN recalled that the consensus on the previous day had been that subparagraph (ii) (A) should not be confined to financial products, but should be limited to regulated exchanges.

20. Mr. MORÁN BOVIO (Spain) said that the Commission would probably wish to exclude markets which were regulated by national law; for example, the stock market was adequately regulated, at least in most European countries.

21. The CHAIRMAN said that the problem seemed to be the use of the equivalent of the word "market" in the other language versions. The idea of the English text was to exclude transactions carried out on a regulated exchange. There was concern that, because sale and purchase transactions in the regular market were regulated in some countries, all such transactions would be excluded from the scope of the draft Convention. The drafting group needed guidance on that point.

22. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that there seemed to be a risk that the scope of the exclusions might be extended. The original intention had been to exclude futures, precious metals and currency exchange contracts; if the word "futures" was deleted, the subparagraph became broader and covered all exchange transactions. The Commission might find it necessary to provide clarification in a commentary, or to specify the exchange markets that were to be excluded from the scope of the draft Convention.

23. The CHAIRMAN said that the issue was whether the other languages had a term which would precisely capture the meaning of the English word "exchange". The Commission had already moved away from the idea of listing goods and services to be excluded, and had expressed support for the idea of specifying the nature rather than the content of the transaction. It certainly did not intend to exclude every transaction in a regulated market. The Commission could leave the issue to the drafting group and revert to it later.

24. Mr. PICKEL (Observer for the International Swaps and Derivatives Association) suggested that the French word "*bourse*" might be closer to the meaning of the English word "exchange".

25. Mr. MORÁN BOVIO (Spain) said that, if the amended English text of subparagraph (ii) (A) was sufficiently clear, it could be left as it stood, with an explanation in the commentary.

26. Mr. DUCAROIR (Observer for the European Banking Federation) said that in France the *bourse* dealt not only with stocks and shares, but also with financial instruments. The amended subparagraph should refer to the regulated exchange of financial instruments.

27. The CHAIRMAN said that, if the Commission followed that suggestion, it would be moving away from its earlier decision that the exclusion would apply not only to financial instruments but also to all receivables arising from transactions on a regulated exchange.

28. Mr. SCHNEIDER (Germany) said that subparagraph (B), as amended, referred to netting agreements and subparagraph (D), as amended, to inter-bank payment systems; however, inter-bank payment systems were largely covered by netting agreements. Moreover, it was not clear whether the exclusion of receivables owed on the termination of all outstanding transactions in amended subparagraph (B) also applied to subparagraph (D), as amended.

29. Mr. COHEN (United States of America) said that the ad hoc group had prepared formulations on the basis of the Commission's tentative decisions of the previous day. Many inter-bank payment systems might well fall under the definition of netting agreements; however, there was a variety of inter-bank payment systems at the current time, and there were likely to be more in the future, which did not fall under that definition. The intention had been to have a specific exclusion for receivables arising under inter-bank payment systems so as to be sure that they were excluded, whether or not they were governed by netting agreements.

30. On the question of the exception for close-out receivables, he said that inter-bank payment systems and investment security settlement systems were both ongoing relationships, and therefore there was no need for a close-out exception.

31. While inter-bank payment systems and investment securities settlement systems were often netting agreements, that was not always the case, and his delegation felt that it was important to exclude those two sources of receivables regardless of whether they qualified as netting agreements. Moreover, the future development of those systems was likely to take unpredictable forms that would not necessarily qualify as financial contracts governed by netting agreements. In either case, his delegation felt that they should be excluded from the scope of the draft Convention.

32. Since there was no market in financing close-out payments owed under inter-bank payment systems or investment securities settlement systems, the exclusion of receivables from those two sources could be a complete exclusion, and there was no need for the exclusion specified in subparagraph (B), as amended.

33. The CHAIRMAN said that the exclusion in subparagraph (B), as amended, was based on the substance of the transaction, while the exclusion in subparagraph (D), as amended, was based on the label of the transaction. There seemed to be a concern that, if an inter-bank payment system was actually a netting agreement, the exclusion in subparagraph (B), as amended, would apply; if it was not, that exclusion would not apply.

34. Mr. SCHNEIDER (Germany) said that the Commission must avoid inconsistencies. If the intention of subparagraph (D), as amended, was to exclude only inter-bank payment systems and investment securities settlement systems which were not covered by netting agreements, that should be specifically stated. Then subparagraph (B), as amended, would set out the general rule and subparagraph (D), as amended, would set out the rule for inter-bank payment systems and investment securities settlement systems not covered by netting agreements.

35. Mr. MORÁN BOVIO (Spain) said that his delegation had no difficulty with the two subparagraphs. Subparagraph (B), as amended, referred to all netting agreements and subparagraph (D), as amended, was specifically concerned with inter-bank payment systems, with which the Commission did not wish to be involved.

The meeting was suspended at 11.30 a.m. and resumed at 12.05 p.m.

36. Mr. PICKEL (Observer for the International Swaps and Derivatives Association) noted that the ad hoc group endorsed the EBF definitions of "financial contract" and "netting agreement" contained in document A/CN.9/472/Add.1. With regard to a possible overlap between subparagraphs (B) and (D), it was helpful to keep in mind that the term "financial contract" in the EBF proposal referred to "any spot, forward, future, option or swap transaction", and that such transactions were distinct in nature from the payment systems and settlement systems referred to in subparagraph (D).

37. The words "any deposit transaction" could be deleted from the definition of the term "financial contract", assuming that the bank transaction exclusion was accepted.

38. Mr. BERNER (Observer for the Association of the Bar of the City of New York) noted that the Commission was dealing with two definitions that limited the general concept of "netting agreement" and excluded many types of bank settlement arrangements, for instance inter-bank settlement arrangements. A settlement between a London bank and a New York bank might or might not be organized along the concept of same currency. There might be a means of set-off based on the day's rates of exchange. According to the definitions, therefore, there was far less overlap than might seem at first sight.

39. Mr. FRANKEN (Germany) said that, even though the financial contracts governed by netting agreements might cover part of the inter-bank payment systems, such systems might not be governed by netting agreements. They should in any case be excluded, because the banks were heavily controlled by the authorities and the Convention could not interfere in those regulated parts of the market.

40. In addition, investment securities settlement systems might or might not be governed by netting agreements. In order to clarify the situation, he proposed the addition to subparagraph (D) of the words "regardless of whether or not governed by netting agreements".

41. Ms. WALSH (Observer for Canada) and Mr. DUCAROIR (Observer for the European Banking Federation) supported the proposal made by the German delegation.

42. Mr. KOBORI (Japan) requested clarification of the German proposal in relation to the exception for a close-out transaction.

43. Mr. FRANKEN (Germany) said that the exception from the exclusion under subparagraph (B) should not be valid for inter-bank payment systems and therefore had not been included in the German proposal concerning subparagraph (D). Receivables arising after termination would be excluded from the draft Convention.

44. The CHAIRMAN suggested that the Commission should move on to the definition of financial contracts. When the Commission had completed its consideration of the United States proposals, it would be testing them against the other provisions of the Convention, as well as weighing their relative merits in relation to variant B.

45. Mr. DUCAROIR (Observer for the European Banking Federation) said that, as the ad hoc group was proposing a special provision to exclude receivables from bank deposits, deletion of the words "any deposit transactions" from the definition of "financial contract" would avoid redundance and make the text clearer.

46. The CHAIRMAN assumed that the Commission agreed with the view expressed and wished to refer the matter to the drafting group.

47. Mr. HERRMANN (Secretary of the Commission), referring to the decision to accept the German proposal, said that the text should indicate that a receivable would be considered in relation to each exclusion individually, irrespective of whether it was covered by another exclusion. If excluded under one provision, the receivable was excluded, regardless of whether it was covered by any other exclusions.

48. Mr. RENGER (Germany) asked whether the EBF definitions of "netting agreement" and "payments or securities settlement systems" had also been endorsed by the Commission.

49. Mr. COHEN (United States of America) said that the proposal from the ad hoc group had incorporated two definitions from the EBF proposal: the definitions of "financial contract" and of "netting agreement". The group had not addressed the issue of whether to include the definition of "payments or securities settlement systems" and it was therefore not part of the proposal.

50. The CHAIRMAN noted that there was no reason to include a definition of terms that did not appear in the text.

51. Mr. DUCAROIR (Observer for the European Banking Federation) pointed out that the EBF definition in question, which was based on a European directive, referred to "any contractual arrangement between three or more participants" and therefore excluded the case of two participants. However, in the case of inter-bank settlement systems, there might be only two participants.

52. Ms. WALSH (Observer for Canada), referring to the EBF definition of "financial contract", proposed the deletion of the words "and any collateral or credit support related to any trans-

action referred to above". A financial contract was a kind of transaction; those words did not fit within the definition and were unnecessary to complete it.

53. Mr. WHITELEY (United Kingdom) said that, in the current formulation of the proposal, only financial contracts that formed part of a netting agreement were covered by the exclusion. Collateral would be relevant only where it was part of the netting structure. Participants in the financial markets might take collateral in the form of a security interest, or there could be a transfer of assets with an obligation to redeliver equivalent assets at a future date. That obligation to redeliver provided priority because it could be netted against the exposure under the netting agreement. For that reason, it was important to retain the reference to collateral in the definition of "financial contract". The structure of that kind of contract was very similar to a repo, and it was clear from the text that the original intention had been for repos to be covered by the exclusions.

54. Mr. COHEN (United States of America) said that, while he appreciated the point made by the representative of the United Kingdom regarding the nature of the transactions, the term "financial contract" was used only to define the type of netting agreement in question. He therefore agreed with the observer for Canada that the final words should be deleted; they added no independent meaning, lengthened the definition and added a term, "collateral", which the Commission had carefully avoided using elsewhere in the draft Convention.

55. Mr. PICKEL (Observer for the International Swaps and Derivatives Association) noted that, in transactions such as those governed by the Association's Master Agreement, credit support was typically provided as backup for the entire exposure under the netting agreement. It might therefore be more appropriate to refer to collateral or credit support in the definition of the term "netting agreement" rather than that of "financial contract". The words "(including any collateral or credit support arrangement with respect to such agreement)" could be inserted after the words "an agreement" in the EBF definition of "netting agreement".

56. Mr. MORÁN BOVIO said that that amendment would clarify the paragraph in the context of actual practice.

57. Mr. COHEN (United States of America) said that his delegation was in favour of a clearer definition of the term "netting agreement". However, it was important not to inadvertently exclude receivables that might be many layers deep in a collateral or credit support agreement; it was the netting agreement that produced the exclusion. He wondered whether the same objective could be achieved by stating that a netting agreement was an agreement as defined in the EBF proposal, whether or not there was a collateral or credit support arrangement with respect to such agreement. Indeed, those words could be included in the definition of "netting agreement", in that of "financial contract" or in both. That solution would allow the Commission to make it clear that the existence or non-existence of collateral or credit support arrangements did not affect the definition of a financial contract or netting agreement without excluding the contents of such arrangements.

58. Mr. PICKEL (Observer for the International Swaps and Derivatives Association) said that his comments had been made because collateral arrangements were closely linked to the Master Agreement and the netting provided under that instrument. Under certain circumstances, whatever credit support was provided was taken into account through the process of terminating the relationship and settling on a net amount owed to one party by the other.

59. The suggestion made by the United States representative had the virtue of making it clear that the netting agreement was the core relationship even where it entailed the provision of collateral.

60. Ms. WALSH (Observer for Canada) said that she was happy to support the United States proposal. However, she remained convinced that the best solution would be to delete the words "and any collateral or credit support related to any transaction referred to above": the Commission was, in effect, stating that the definition of financial contracts and netting agreements was not dependent on whether they included provision for collateral or credit support.

61. In reply to the comment made by the representative of the United Kingdom, she drew attention to the reference to "repurchase or securities lending transaction" in the EBF definition of "financial contract".

62. The CHAIRMAN said that there appeared to be little support for reconsidering the Canadian proposal.

63. Mr. COHEN (United States of America) said that either the Canadian proposal or the amendment proposed by his own delegation would be preferable to leaving the text in its current form.

64. Mr. PICKEL (Observer for the International Swaps and Derivatives Association) suggested that the matter should be dealt with through informal consultations between the representatives of the United States and the United Kingdom, the observers for Canada, ISDA and EBF, and other interested delegations.

65. Mr. MORÁN BOVIO (Spain) supported that suggestion.

66. Mr. DESCHAMPS (Observer for Canada) said that, while delegations were aware of the importance of not creating problems in connection with the derivative instruments governed by the ISDA Master Agreement, the definition of "financial contract" and the issue of financial contracts governed by netting agreements went far beyond those instruments. It was important not to extend the definition of "financial contract" to a point where large numbers of standard banking transactions would be included.

67. For example, most companies which dealt with banks and sold abroad had access to foreign exchange lines of credit. For mid-size businesses, exposure was secured by general assignment of accounts receivable. The proposed definition of "financial contract" would include all security given to the bank in order to secure the customer's obligations under a financial contract since the term "collateral" would include any kind of security given in order to secure such a contract; such a result must be prevented.

68. The CHAIRMAN pointed out that, under the ad hoc group's proposal, only financial contracts governed by netting agreements would be included.

69. Mr. DESCHAMPS (Observer for Canada) said that the problem remained since hedging contracts, even in the case of small businesses, invariably contained a netting agreement.

70. Mr. WHITELEY (United Kingdom) noted that the protection provided by netting agreements required close-out as a preliminary to the procedure in which different exposures were netted against each other to provide a single amount due. It appeared from the example given by the observer for Canada that, in cases involving the assignment of accounts receivable, it would be difficult for the latter to be closed out in any way.

71. Mr. DESCHAMPS (Observer for Canada) said that, of course, not every assignment of receivables constituted a financial contract. To clarify his point, he gave the example of a company whose dealings with a bank involved both a business loan and a foreign exchange futures transaction; the latter constituted a financial transaction and was invariably governed by a netting agreement since the framework contract stipulated that in case of default all transactions would be terminated. The company's debt to the bank from both the business loan and the foreign exchange futures transaction was secured by collateral.

72. The definition of "financial contract" included all collateral from financial contracts; thus, if the bank obtained title to all the company's receivables in consideration of everything owed to it from the latter's foreign exchange futures transaction, it might be disappointed to find that the Convention's provisions regarding the collateral related to the receivable did not apply. Yet the purpose of the draft Convention was precisely to cover normal trade receivables. Thus, unless the reference to collateral or credit support was deleted, the result would be quite contrary to the original intention.

73. Mr. WHITELEY (United Kingdom) said that, as he understood the drafting originally proposed, if the collateral arrangement was not part of the netting agreement and did not rely on that agreement to give it effect, it would not be covered by the exclusion. Thus, he saw no need to delete the reference to collateral or credit support.

The meeting rose at 1 p.m.

Summary record of the 683rd Meeting

Thursday, 15 June 2000, at 3 p.m.

[A/CN.9/SR.683]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 3.05 p.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.4)

1. Mr. KRONKE (Observer for the International Institute for the Unification of Private Law (UNIDROIT)), said that UNIDROIT, having prepared two draft texts on secured transactions, was conscious of the expectation of many countries that the cost of credit for infrastructure investments could be reduced through improvements in the legal framework for taking security. There was now a need to coordinate the draft UNIDROIT Convention on International Interests in Mobile Equipment with the UNCITRAL draft Convention on Assignment in Receivables Financing. The UNIDROIT draft would apply to secured transactions where security was taken in clearly delimited categories of high-value and extremely mobile equipment which was intended to cross borders on a daily basis or to be located outside any national territory. The assets to which it would apply were uniquely identifiable "associated rights". It would create a genuinely international interest, which if registered would give its holder priority, and the register would be based on assets, not debtors. In the past, the Commission had been reluctant to endorse the solution preferred by the UNIDROIT secretariat for coordinating its work with that of UNCITRAL, which was to exclude from the sphere of the UNCITRAL draft Convention the assignment of those few receivables which became "associated rights" by virtue of the financing arrangements proposed in the UNIDROIT draft Convention. However, its objections had been overcome through the definition of the mobile equipment to be covered by the UNIDROIT draft Convention, which was now confined to aircraft equipment, railway rolling stock and space property. UNIDROIT had set up three expert groups to deal with those types of equipment.

2. At a recent meeting of Government experts in Rome, it had been asked why, under the UNIDROIT system, the claim followed the security interest, instead of the other way round, as in most legal systems. The answer given by the UNIDROIT Rapporteur was that it would otherwise be necessary to deal with assignment, thus encroaching on the domain of the UNCITRAL draft Convention. The UNIDROIT text was now being finalized and would be put to a diplomatic conference in the near future.

3. He emphasized that manufacturers, buyers, financiers and the legal profession were looking to the work of both bodies for clarity and predictability in the law. It was important to avoid vague or ambiguous terminology. The best solution would be simply to exclude, in straightforward terms, the limited areas covered by the UNIDROIT draft from the scope of the draft UNCITRAL Convention.

4. Mr. WARSCHOT (Observer for the International Institute for the Unification of Private Law (UNIDROIT)) explained that he was responsible for the working group on railways, which represented railway interests in Europe, North America and South Africa. His group shared the concerns of the working group on aviation regarding the compatibility of the provisions of the UNCITRAL draft Convention with a specified category of receivables, that of associated rights in financed mobile equipment. Both working groups favoured the exclusion of those receivables from the scope of the UNCITRAL draft Convention.

5. Mr. STITES (Observer for the International Institute for the Unification of Private Law (UNIDROIT)) said that the working group on space objects, for which he was responsible, represented the global aerospace industry, satellite operators and the financial community. His working group took the view that space objects, like railway equipment, should be dealt with in protocols specifically covering such equipment.

6. Mr. BURMAN (United States of America) welcomed the collaboration of UNIDROIT and hoped that the respective interests of UNCITRAL and UNIDROIT could be clearly delimited in the two forthcoming instruments. Each text must respect the scope of application of the other, and for that purpose, the Commission should ensure that its own draft was free of complica-

tions. It was important to facilitate the financing of the transactions involved in international infrastructure.

7. Mr. MORÁN BOVIO (Spain) also expressed his appreciation of the work of UNIDROIT and its endeavours to cooperate with the Commission. The UNIDROIT draft Convention was much narrower in scope than the Commission's, but the problem remained of resolving contradictions between the two. There was a danger that the long-term financing system envisaged in the UNIDROIT draft would conflict with the short-term arrangements contemplated for receivables in the Commission's text. Because the receivables covered in the work of UNIDROIT were financed in a highly specific manner and had their own refinancing arrangements, they were in effect separated from the receivables covered in the Commission's own draft. In his Government's view, it was therefore unnecessary to exclude them from the Commission's text. He was anxious to know whether the UNIDROIT representatives perceived the two sectors as being different in nature and, if so, what the differences were with regard to instalments of payment.

8. The CHAIRMAN invited the Commission to resume its discussion of the additional definitions proposed by the European Banking Federation (EBF) (A/CN.9/472/Add.1, p. 12) for inclusion in article 6 of the draft Convention on Assignment of Receivables. The observer for Canada had suggested deleting from the proposed definition of "financial contract" the last phrase, which read "and any collateral or credit support related to any transaction referred to above".

9. Mr. WHITELEY (United Kingdom) said that his delegation was prepared to withdraw its original objection to the Canadian suggestion.

10. Mr. COHEN (United States of America) said that, subject to the change in the definition of "financial contract" just read out, his delegation fully supported the EBF definition of "netting agreement".

11. The CHAIRMAN noted that there seemed to be tentative agreement on the definitions of "financial contract" and "netting agreement" but little interest in considering further definitions. He therefore invited the Commission to resume discussion of the exclusion in subparagraph (ii) (F) of the United States proposal in document A/CN.9/XXXIII/CRP.4.

12. Mr. COHEN (United States of America) recalled that the previous afternoon the Secretary of the Working Group on International Contract Practices had suggested an alternative wording of "receivables arising from the sale or lease of real estate". His delegation would support that change, which would ably serve the purpose of avoiding conflict with long-standing local real-estate law.

13. Mr. STOUFFLET (France) said that he saw no problems in excluding receivables arising from a sale of real estate, but he had some doubts about the wisdom of excluding receivables arising from a lease. The securitization of future lease payments, particularly on commercial space, was a common method of financing for real-estate companies. Securitization of mortgages was also a growing practice. He did not see that their exclusion was justified.

14. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that, although he had suggested new wording for the exclusion, he was not yet convinced that receivables from real estate should in fact be excluded. The problem appeared to be that the priority rule whereby the law of the assignor's location would apply to receivables arising from real estate would conflict with the normal rule in real-estate law whereby the law of the location of the property would apply. The observer for Canada had suggested the approach of devising a different priority rule for assignment of real-estate receivables rather than excluding them altogether. It also appeared that the draft Convention could usefully cover securitization of receivables secured by mortgages if the priority-rule problem was appropriately dealt with.

15. Mr. DOYLE (Observer for Ireland) said that his delegation supported the exclusion as redrafted. He had clear instructions that the industry in Ireland was unhappy about having the draft Convention apply to any aspect of real estate, including securitization of mortgages.

16. Ms. WALSH (Observer for Canada) said that her delegation would prefer a more qualified approach short of outright exclusion, so that securitization transactions on lease and mortgage payments could enjoy the benefits of the draft Convention other than the priority rule. Her delegation would be willing to propose language to that effect if the Commission wished.

17. Mr. BERNER (Observer for the Association of the Bar of the City of New York) noted that the exclusion as it stood mentioned only the sale or lease of real estate. Since many lawyers would not consider sale and mortgage to be the same thing, if the Commission wished the exclusion to cover mortgages as well, perhaps the wording should be "receivables arising from the sale, mortgage or lease of real estate".

18. Mr. MORÁN BOVIO (Spain) said that assignment of lease or rental payments accounted for a substantial movement of funds, and it would be advantageous for that market to be covered by the draft Convention. He wondered if the Irish objections to application of the draft Convention to real estate related to sale only or extended to lease receivables as well.

19. Mr. DOYLE (Observer for Ireland) said that his delegation was aware that the Commission worked by consensus and, having put its reservations on record, would not oppose any measure acceptable to the group as a whole. His instructions had been to report that industry in Ireland would be unhappy with the application of the draft Convention to real property, and specifically with its application to securitization of mortgage receivables. He had no special instructions as to leases.

20. Mr. COHEN (United States of America) said that his delegation would like the exclusion to refer to the sale or lease of real estate, for two reasons. First, in the law of many States, rental or lease income was considered to be an interest in real estate and was covered by local law. Second, it was not always easy to distinguish lease from sale; many complex transactions called "leases" were, in economic reality, sales.

21. Ms. McMILLAN (United Kingdom) said that her delegation would prefer the exclusion of receivables from both the sale and the lease of real estate. If, however, there was a broad consensus not to exclude lease receivables, her delegation would agree, but only if the priority rule pertaining to them was altered.

22. Mr. SCHNEIDER (Germany) said that his delegation shared the concerns of the observer for Ireland and would like to have the wording of the clause specifically exclude receivables secured by mortgages.

23. Mr. MORÁN BOVIO (Spain) said that, if Governments had given delegations instructions concerning real estate, it was out of a concern to protect domestic real-estate systems. However, the draft Convention was designed for international use. The Commission should bear in mind the needs of construction firms planning large projects in developing economies. If their

access to credit was restricted because they were not covered by the draft Convention, development would suffer. From that perspective, it was perhaps worthwhile to follow the suggestion of Canada and seek an accommodation of the rules applying to jurisdiction in order not to exclude such transactions from the benefits of the draft Convention.

24. Ms. WALSH (Observer for Canada) said that her delegation was not in favour of excluding receivables that took the form of rights to payment under a mortgage. Potential conflicts with local real-estate law could be dealt with through a relatively minor change in article 24 to the effect that the choice-of-law rule would apply without prejudice to a person with an interest in the land under the law of the jurisdiction where the land was located. In other words, if the competition for priority was between two assignees or an assignee and an insolvency administrator, the law of the assignor's location would continue to apply. But if the competition was between an assignee of the receivable and a claimant with an interest in the land who was entitled to priority under the law of jurisdiction where the land was located, the draft Convention would revert to the lex situs rule.

25. Mr. DOYLE (Observer for Ireland) said that his delegation preferred the formulation that would exclude receivables arising from sale or mortgage of real estate. Traditionally, real property came under national law, and mortgages in his country were viewed as part of real property. Any alternative rule would be a fundamental deviation from Irish law and would make ratification of the draft Convention much more difficult. The wording proposed by the Association of the Bar of the City of New York and supported by Germany would meet Ireland's concerns, whereas Canada's proposal did not, but his delegation would abide by the consensus of the Commission.

26. Mr. STOUFFLET (France) said that he heartily supported the proposal of Canada, which should be viewed, not as a compromise, but rather as the fruit of a remarkable legal analysis.

27. Mr. KUHN (Observer for Switzerland), supported by Mr. MEDIN (Observer for Sweden), said that his delegation supported the Canadian proposal. The Commission should be careful about excluding more from the draft Convention than was strictly necessary. In the important area of project financing, for example, many projects involved real estate, and the assignment of receivables flowing from them would therefore remain outside the draft Convention if the latter contained a wholesale exclusion of real estate.

28. Mr. COHEN (United States of America) said that his delegation would have to consider the Canadian proposal in writing before responding to it.

29. The CHAIRMAN said that there seemed to be general agreement on excluding sales of real estate but divided opinion on leases and securitization of mortgages.

30. Ms. WALSH (Observer for Canada) said that her delegation's proposal would work equally well for receivables arising from either leases or mortgages. Before the Commission considered article 24, her delegation would try to devise language applicable to one or the other or both.

31. Mr. BURMAN (United States of America) said that he wished to make the point for the record that most project-financing structures were deliberately designed so that the flow of receivables would not be tied to the real property and hence to local real-estate laws.

32. The CHAIRMAN invited the Commission to turn to consideration of exclusion (ii) (G) in the United States proposal (A/CN.9/XXXIII/CRP.4).

33. Mr. COHEN (United States of America) said that his delegation proposed excluding drawing rights or rights to payment under a letter of credit or independent bank guarantee because such receivables were covered by other international instruments and well-known rules, such as the Uniform Customs and Practice for Documentary Credits and the International Standby Practices (ISP98). The Commission should be wary of dealing with those categories in a way that would conflict with carefully elaborated systems.

34. The CHAIRMAN said that, in the absence of comment, the exclusion could be considered as meeting with tentative approval, and the Commission could move on to consideration of exclusion (ii) (H) of the United States proposal (A/CN.9/XXXIII/CRP.4).

35. Mr. COHEN (United States of America) said that although receivables arising from foreign-exchange contracts fell partly under subparagraphs (ii) (A) and (ii) (C) of his proposal, there were foreign-exchange contracts that did not fit into either of the categories of regulated future exchanges or netting agreements. Nor were they well-suited to Convention rules, many of which would need to be re-examined if the receivables in question were not excluded. The foreign-exchange market was highly specialized and was already functioning well.

36. Mr. SCHNEIDER (Germany) asked for examples of receivables that had not been covered by the two other exclusions.

37. Ms. GROSS (Observer for the International Swaps and Derivatives Association (ISDA) and the Financial Markets Lawyers Group) said that, although it had become common in the past several years for banks and their customers to conduct foreign-exchange transactions under ISDA Master Agreements, many transactions were still not governed by such documents. Banks, relying either on set-offs under local law or set-offs in bankruptcy, simply agreed to exchange currencies, confident that they could thus net all amounts payable to the customer against all amounts payable to them by the customer. If, however, any of those amounts were to become assignable to other creditors, thus interfering with netting, it would have a seriously deleterious impact on banks that were counting on having a total exposure to the customer on a net basis.

38. Mr. FRANKEN (Germany) observed, that even in the cases just described, banks could no doubt enter into agreements which, though not based on an ISDA or some other master agreement, provided for a netting procedure; in which case, transactions involving currencies would in fact be covered by financial contracts that came under the definition of a netting agreement.

39. Mr. DESCHAMPS (Observer for Canada), concurring, said that agreements such as foreign-exchange contracts between commercial banks and exporters contained netting provisions and therefore fell within the definition of a netting agreement under subparagraph (ii) (C) of the United States proposal. Consequently, subparagraph (ii) (H) was unnecessary.

40. Ms. GROSS (Observer for the International Swaps and Derivatives Association (ISDA) and the Financial Markets Lawyers Group) said that many banks did indeed enter into foreign-exchange contracts with netting provisions. However, many foreign-exchange contracts were concluded on a Reuters dealing system, where confirmation contained merely the terms, with no provision for netting. Banks entering into such contracts were relying on statutory, not contractual, netting provisions.

41. Mr. MORÁN BOVIO (Spain) said that, having listened to the ISDA expert, he now favoured exclusion. The fact that such contracts were not always netting agreements might give rise to

assignable credits, and the draft Convention should not cover such credits derived from foreign-exchange contracts. Although the transactions in question represented a very tiny market, it was a well-functioning and very particular one that should be excluded.

42. Mr. RENGER (Germany) said that the more he heard, the more he was convinced that there was no logical reason for exclusion. Banks concluding foreign-exchange contracts had autonomy and complete freedom of contract and could add netting provisions if they wanted such transactions to fall outside the Convention. The Commission needed a legal basis for excluding something from the draft Convention.

43. Ms. GROSS (Observer for the International Swaps and Derivatives Association (ISDA) and the Financial Markets Lawyers Group) observed that the foreign-exchange market was actually very large: a total of $ 1.2 trillion per day was traded, with economic results very crucial to the health of the world financial system. Foreign exchanges were conducted under a centuries-old system of contract operations. She urged the Commission to hesitate before adopting provisions that would upset the balance and liquidity of the financial markets.

44. Mr. WHITELEY (United Kingdom), agreeing with the German delegation that there should be justifiable reasons for all exclusions to the draft Convention, suggested that in the current instance one possible reason might be that certain States wanted to control transfers of foreign exchange and that a provision allowing assignment despite such controls would not be desirable. That was not currently a United Kingdom concern, although it had imposed such controls in the past.

45. Ms. McMILLAN (United Kingdom) drew attention to article 4 (2) of the draft Convention, which allowed Contracting States to list in a declaration all assignments to which the Convention would not apply. For the sake of consistency, that paragraph too should be deleted.

46. Ms. WALSH (Observer for Canada), referring to the first point made by the United Kingdom delegation, said that her delegation did not read the draft Convention as superseding national regulatory law on foreign-currency exchanges, money laundering and the like. The Commission would be revisiting those issues and making them explicit in draft article 9. As to draft article 4 (2), it was precisely because of the illogicality of allowing Contracting States to expand or contract the scope of the Convention at will that the text had been placed in square brackets.

47. Mr. STOUFFLET (France), noting that the foreign-exchange market was not the only one that dated back centuries, said that he agreed with the German delegation that logic and rationality had to be maintained, even in small matters. The Commission should not take a decision that would please a particular sector when there was no legally justifiable reason to do so.

48. Mr. DOYLE (Observer for Ireland), supporting the delegations of France and Germany, said that the Commission had set out to give receivables as wide a scope as possible and to exclude them only when there was an overwhelming reason for so doing. For instance, it had been clear that the draft Convention could not apply to bank deposits. On the other hand, the fact that the insurance industry did not wish insurance contracts to be covered by the draft Convention had not been deemed a sufficient reason; and the same applied to foreign-exchange contracts.

49. Mr. BERNER (Observer for the Association of the Bar of the City of New York) noting that the goal of the draft Convention was to break down barriers to increased global financial transactions, said that including foreign-exchange contracts in the Convention did not appear to contribute in any way to that goal. Foreign-exchange operations had a long history, and there was no point in introducing uncertainty into well-established practice. By including foreign exchange contracts, the Commission would be discouraging parties from entering into such contracts because they would have to deal with a whole body of new law, with no compensatory contribution to international trade.

50. Mr. MORÁN BOVIO (Spain) said that, far from being useful to the foreign-exchange market, the draft Convention would hinder it by allowing assignment. That alone was legal reason enough for exclusion.

51. Mr. BURMAN (United States of America), recalling that the general purpose of the draft Convention as set out in the preamble was to promote the availability of international commercial credit to markets at more affordable rates, said that the Convention could make a particular difference in regions that had need of credit but a limited capacity to obtain it. That should be the Commission's litmus test for every provision. It was a question, not of providing rationales, but of serving industries.

52. The CHAIRMAN said that there was clearly need for more consultations on the issue. He would be interested in hearing further from the actual practitioners.

53. Mr. DUCAROIR (Observer for the European Banking Federation (EBF)) said that obviously the United States delegation had correctly stated the objectives of the draft Convention. If, however, the Convention could introduce useful rules, it should surely do so. He had received no mandate from Federation banks to argue for exclusion, and he therefore favoured inclusion.

54. Mr. PICKEL (Observer for the International Swaps and Derivatives Association (ISDA)) said that the foreign-exchange market was the single most efficient market in the world, trading a daily total of over a trillion dollars in all the world's currencies. In the process, it provided low-cost access to foreign exchange, and the goals of the preamble were thus being largely achieved already through the marketplace.

55. Mr. BERNER (Observer for the Association of the Bar of the City of New York) said that his delegation would feel more confident about inclusion if it heard how the draft Convention would benefit foreign-exchange transactions.

56. The CHAIRMAN said that the reverse situation applied. Since the Commission had in previous sessions taken a decision that the draft Convention should be applied as broadly as possible, the burden of proof fell on those who argued for exclusion. There was also the matter of draft article 4 (2), to which the United Kingdom had referred. It had originally been conceived as a safety valve of sorts, but the matter had still to be discussed.

57. Ms. GROSS (Observer for the International Swaps and Derivatives Association (ISDA) and the Financial Markets Lawyers Group) said that one of the most important benefits banks derived from netting was the opportunity to reduce their credit exposure to clients and reduce the capital they must maintain in the various countries in order to keep themselves strong. Chase Manhattan Bank, for instance, did $3 trillion worth of transactions with counterparties, which, through netting, could be reduced to an exposure of only $30 billion. If, however, banks knew that their customers could assign receivables to counterparties, thereby destroying the mutuality necessary for netting, they would be required to maintain more capital for bank regulators, and internal credit exposure charges would in turn be higher, causing banks to raise their rates to their customers.

Furthermore, if banks had to take steps to place the many transactions currently not covered by netting agreements under such agreements, that too would raise costs and ultimately would increase the banks' legal exposure and increase legal uncertainty. There were therefore very strong reasons why all foreign-exchange transactions should be excluded from the draft Convention.

58. Mr. FRANKEN (Germany) said he believed that the representative of ISDA was painting too dark a picture of the consequences of inclusion. Most substantial foreign-exchange transactions fell under agreements that contained a netting clause, so that the volume of transactions at issue was small. Also, one should never underestimate the inventiveness of banks: they were always able to circumvent problems. The clause in question would not cause the foreign-exchange market to collapse.

59. Mr. FERRARI (Italy) said that foreign-exchange contracts should be included in the draft Convention. The figures just given by the ISDA representative, presumably as an argument for exclusion, actually referred to transactions under netting agreements; but even if they did not, the market would not crash.

60. Mr. AL-NASSER (Observer for Saudi Arabia) observed that delegations had rightly referred to the importance of foreign-exchange contracts to developing countries. As an official of the Central Bank of Saudi Arabia, he himself had researched the reasons for delays in foreign-exchange transactions and had found that the main reason was the lack of an explicit foreign-exchange contract. Some countries maintained long-term contracts with banks in order to avoid currency-rate fluctuations. The issue had to be clarified and demystified. He urged the Commission not to exclude foreign-exchange transactions from the draft Convention.

61. The CHAIRMAN said that there was clearly a preference that foreign-exchange transactions should not be excluded.

62. He invited the Commission to consider exclusion (I) of the United States proposal (A/CN.9/XXXIII/CRP.4).

63. Mr. WINSHIP (United States of America) said that the proposal in subparagraph (I) for investment securities settlement systems had now been approved and combined with payment systems. However, subparagraph (I) also dealt with the sale or lending of investment securities, including repurchase agreements, known as repos. The transactions in question included investment security transactions which took place in well-established markets. Some rules in the draft Convention, especially the rules on priority, debtor protection and location, did not work well for such transactions. To apply the Convention to them would create uncertainty and would not be beneficial for the markets concerned.

64. The CHAIRMAN invited the Commission to decide whether the principle it had adopted for the previous exclusion should also apply in the present instance.

65. Mr. DESCHAMPS (Observer for Canada) supported exclusion of the rights specified in subparagraph (i), mainly because the law in that area was in a state of constant flux and national legislative systems were being amended to keep pace with it. Moreover, it was not certain whether the rules of private international law in the draft Convention were applicable to the law governing the sale of securities and securities entitlements. It also appeared that the Hague Conference on Private International Law was undertaking its own work on the topic. For those reasons, it seemed advisable to defer a decision on which rules of private international law were applicable to transactions of the type concerned.

66. Mr. RENGER (Germany) said that the fear of impeding the operation of existing markets did not constitute a sufficient legal justification for excluding certain types of transaction from the scope of the draft Convention. If there was a need for exclusion, for instance because security investments were highly regulated under internal law, those concerns could be dealt with by way of the reservation formulated in draft article 4 (2), instead of a general exclusion clause.

67. Mr. MORÁN BOVIO (Spain) said that the solution contained in article 4 (2) was the least desirable one from the standpoint of the draft Convention. All of the Commission's efforts for the past few days had been aimed at preventing the list of exclusions from growing. The text itself must specify the limits of its own applicability.

68. The point was not simply that the repurchase agreements market was a well-functioning one. If the draft text was applied to that market, it could suffer distortions, particularly in the area of transferable securities. It did not seem appropriate to introduce a rule whereby the possibility of transferring securities through receivables deriving from securities should have absolute recognition as it did in the draft Convention. The primary advantage of the draft Convention was that it ensured that receivables were easily transferable. That brought it into direct conflict with many of the agreements in question, which frequently involved other aspects of the market. For those reasons, his delegation was in favour of maintaining the exclusion as reformulated.

69. Mr. FERRARI (Italy) said that his delegation was not in favour of dealing with the issue at hand by referring to article 4 (2).

70. Ms. KISSEDJIAN (Observer for the Hague Conference on Private International Law) said that the project to which the observer for Canada had referred was not a hypothetical one. The States members of the Hague Conference on Private International Law had taken a firm decision to launch the project at their Special Commission held in May. According to the expert presentations made on that occasion, not only national legislation but markets were in a state of flux. There were no established practices on the part of firms and of financial intermediaries which held securities. The fact that in Europe mergers were taking place not only between intermediaries but between stock exchanges would further complicate practice in that area. For those reasons, it would be premature to establish any rule, even the one proposed by the Secretary of the Working Group, which delegations appeared to prefer.

71. The CHAIRMAN said that there appeared to be considerable support for the proposed exclusion in the Commission.

72. Mr. IKEDA (Japan) said that in the history of the Working Group, attempts had been made to exclude receivables in order to avoid conflicts stemming from the application of draft articles 11 and 12 to new banking operations. That should be kept in mind in evaluating the current proposal.

73. The CHAIRMAN suggested that it might be useful for the ad hoc discussion group to produce a new draft of the exclusions, incorporating the decisions reached after discussion, so that the Commission could compare what had been achieved with the proposals, in particular, variant B of draft article 5.

74. Mr. WINSHIP (United States of America) said he did not believe that his delegation's proposal was inconsistent with variant B.

75. The CHAIRMAN suggested that, in addition to a list of the exclusions arrived at after discussion of the United States pro-

posal, a list could also be drawn up of the items not to be excluded, but to be tested against other provisions of the Convention, particularly draft articles 9 and 24. It was necessary to look at the text in its entirety in order to determine whether variant B was still needed and, if not, whether the text could stand on its own. If the Commission agreed to that approach, the discussion could be deferred until a text had been produced.

76. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices), summarizing the discussion on draft article 6, said that the location issues had been resolved; the definition of receivables financing had been put on hold, to be discussed in the context of the title and preamble of the draft Convention; subparagraph (H) of document A/CN.9/XXXIII/CRP.4 would be discussed in the context of the priority provisions; and the definition of trade receivables would be discussed only after the Commission had decided whether or not it would adopt variant B of draft article 5.

77. Ms. WALSH (Observer for Canada), referring to draft article 6 (k) (A/CN.9/470), suggested that the term "returned goods" should be excluded unless its meaning was clarified. Her delegation understood that the term was intended to refer to a situation where goods that were the subject of the original contract were returned by the other party to the contract, because they were defective, because the original contract was terminated, or because the goods were repossessed. The rationale for excluding such goods from the definition of "proceeds" was that it would be inappropriate to apply the choice-of-law rule, as set out in draft article 24, to proceeds which took the form of returned goods. She doubted, however, whether users of the draft Convention would understand that intention, given the summary language in which the subparagraph was drafted. Moreover, she questioned the need for such an explicit exclusion. Returned and repossessed goods were not proceeds of a receivable in the way in which such proceeds had been defined in the draft Convention.

78. Mr. SALINGER (Observer for Factors Chain International (FCI)) said that, in the minds of most factoring practitioners, returned goods constituted a large part of their recoveries from debtors and were in fact proceeds. If the factors did not have those proceeds, their risk increased enormously, as did the cost of their granting credit.

79. While he understood that there might be conflicts between the priority rules under the draft Convention and priorities from the standpoint of the laws of the State in which the goods were located, he believed that if the priority rules were applied once the proceeds had been returned to the State of the assignor, no conflict would ensue.

80. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the issue to which the previous speakers had referred was reflected in draft articles 16, 24 and 26. That issue had been discussed at length in the Working Group, and it might be preferable to consider the definition of "returned goods", as well as the priority rules, in the context of the relevant articles.

81. Mr. RENGER (Germany) said that the Commission had agreed that it would take up the proposal by the European Banking Federation concerning the definition of financial contract that was to be included in draft article 6. Moreover, with regard to the exclusions, the Commission had agreed in substance regarding inter-bank payment systems and security settlement systems. It was unclear whether definitions of those terms should also be included in draft article 6, as proposed by EBF.

82. The CHAIRMAN said that the previous speaker's question had been discussed when the Commission had considered the definitions in draft article 6.

The meeting rose at 6 p.m.

Summary record of the 684th Meeting

Friday, 16 June 2000, at 10 a.m.

[A/CN.9/SR.684]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.10 a.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.4)

1. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that, having completed its consideration of the list of practices or receivables that would be excluded from the scope of the draft Convention, the Commission needed to decide what to do with the list. The first alternative would be to exclude those practices or receivables from the scope of application of the draft Convention as a whole, either under article 2 or under article 4, and possibly exclude certain practices only from the scope of articles 11 and 12. The main argument against partial exclusions was that a limited exclusion from articles 11 and 12 would mean that the exclusion of the practices concerned would depend on the existence of an anti-assignment clause and on the effect given to that clause by the applicable law.

2. The second alternative, which already existed in article 5, variant B, was to limit the scope of articles 11 and 12 to assignments of trade receivables. The exclusion of those practices would then be left to the parties, which would have to ensure that the anti-assignment clause was subject to a law which gave effect to it.

3. The Working Group had also taken up the question of the definition of trade receivables. The Commission might wish to consider whether it would be easier to define trade receivables rather than all types of financial receivables.

4. A third alternative, which was identified in the commentary, would be to amend article 11. It seemed that the provisions of that article might not work well in a great many cases. Article 11 focused on trade receivables, especially future receivables and bulk assignments; however, in the case of future receivables,

there was as yet no contract, and in the case of bulk assignments, there were hundreds of contracts. Article 11 could therefore be turned around so that it would give effect to anti-assignment clauses, thereby eliminating the uncertainty attached to having the effectiveness of anti-assignment clauses left to law applicable outside the draft Convention. There would then be a single exception, for trade receivables. That approach would meet the needs of practices where anti-assignment clauses were routinely included and put into effect.

5. The CHAIRMAN said that the Commission seemed to agree that there should be a general definition of what would be encompassed within the draft Convention, but that it was not desirable to have a list of inclusions. The question then arose whether the list of exclusions should relate to the whole of the draft Convention, or only to certain provisions. Finally, the Commission needed to decide whether it wished to change article 11 from a provision that negated anti-assignment clauses to one that confirmed such clauses, with the proviso that it would not apply to trade receivables.

6. Mr. WINSHIP (United States of America) recalled that the ad hoc group on exclusions had prepared an informal text on excluded transactions, which had been read out at the 682nd meeting. The group had decided to seek clarification from the Commission as a whole on the issue of assignments of receivables arising from the sale of land.

7. The ad hoc group had also reached agreement that the terms "financial contract" and "netting agreement" should be defined, and that the definitions should be those suggested by the European Banking Federation, in document A/CN.9/472/Add.1, except that in the definition of "financial contract", in article 6, paragraph (n), the words "any deposit transaction" and the phrase "and any collateral or credit support related to any transaction referred to above" should be deleted. The group had also clarified that inter-bank payment systems involving only two banks would not be covered by exclusion (D).

8. His delegation considered that the language suggested by the ad hoc group was acceptable, and believed that the approach of total exclusion was preferable, for the reasons it had already explained. If that approach was not acceptable to the Commission, each of the transactions would need to be considered in the context of article 5, variant B, so that the Commission could consider whether a lesser exclusion would be appropriate for any or all of them. The list could then be included under variant B. His delegation noted, however, that variant B might not be sufficient; on the previous day, it had drawn attention to the need to adapt other provisions, such as the provisions of article 24, with respect to some of the practices in the list.

9. Mr. IKEDA (Japan) said that the list of exclusions should relate to the draft Convention as a whole; it did not support the idea that assignments of some receivables should be partially excluded from the scope of the draft Convention.

10. Ms. GAVRILESCU (Romania) said that, if a list of exclusions was to be included in the draft Convention, it should be a list of total exclusions. Furthermore, it must cover receivables arising from the sale of land. In Romania, international land transactions were prohibited under the Constitution and under a special law. Since the objective of the draft Convention was to develop international trade, receivables arising from the sale of land must be excluded from its scope.

11. The CHAIRMAN said that the Commission needed to decide whether there should be a list of items which would be covered by the draft Convention. There had been strong support for the position that there should not be such a list, but a general statement of what would be included. Depending on how that statement was formulated, the items set out in article 4 (1) could either be included within the general statement or excluded from it. If they were excluded, there would need to be additions to the list of exclusions recommended by the ad hoc group. The group's recommendations related only to the list of exclusions proposed by the United States delegation (A/CN.9/XXXIII/CRP.4) and was premised on the assumption that there was an exhaustive list of inclusions.

12. Mr. MORÁN BOVIO (Spain) said that a list of inclusions did not seem appropriate, as the draft Convention could function rather well over a long period of time with just a few clear exclusions. If the draft Convention did contain two lists, there might be problems with issues that were not defined. His delegation supported the list of exclusions suggested by the ad hoc group.

13. He agreed with the observer for Canada that receivables resulting from the sale of land could be dealt with by means of article 24, and should not be excluded under article 2.

14. The current trend in the securitization sector was to bring together receivables related to real estate and those relating to movable property, as the customers of credit agencies were very happy with the yields provided by those securities both for assignment transactions and the receivables resulting from them.

15. Mr. WINTHROP (United States of America) said that his delegation's original support for a list of inclusions reflected its very practical approach. Trade receivables, intellectual property receivables and loan receivables had seemed to be the basic core transactions that would benefit from uniform rules in the area of assignment of receivables. Other types of transaction might also benefit. There were also financial transactions, many of which appeared on the list of exclusions, which were already well established or unlikely to benefit from such rules. The uniform rules themselves did not work well with respect to the appropriate priority rule, representations, anti-assignments, and identification of location, and might actually be detrimental to certain existing or evolving markets. However, the Commission could start with those cases where the rules were clearly beneficial, and perhaps make additions to that list when necessary. After consultations with industry groups, his delegation had started with a more limited list of transactions, but had still gone beyond the 1988 UNIDROIT Convention on International Factoring by including, in addition to trade receivables, loans, credit facilities in certain limited circumstances, and receivables arising from intellectual property.

16. Despite the lack of support for that approach, it still seemed the most effective way of approaching the practical problems of the global market for receivables and the Commission might wish to consider that issue again after considering variant B of article 5, or when it had examined each of the potentially difficult areas.

17. Ms. GAVRILESCU (Romania) said that transactions relating to land should be added to the list of exclusions in the draft Convention. Otherwise, the text would contradict a very important provision in the national legislation of Romania.

18. If there was a list, it should naturally include all the exclusions to which the Commission had referred. If land transactions were not included on that list, her delegation could, as a last compromise, support retaining article 4 (2) in its present form in order to be able to exclude some situations that did not conform to Romanian law.

19. Mr. MEDIN (Observer for Sweden) said that consultations with Swedish industry had revealed a preference for variant B of

article 5. Sweden had always been concerned that assignments of financial receivables did not fit in the draft Convention and was grateful to the United States delegation for the list of transactions to be excluded. His delegation supported their exclusion from the draft Convention as a whole.

20. If assignments of financial receivables were indeed to be excluded from the draft Convention, his delegation would withdraw its support for the retention of articles 4 (2) and 39, as they would no longer be required for that purpose.

21. Finally, with regard to the sale of land, he had understood that the Commission was in favour of exclusion of transactions relating to the sale of land, except in the case of lease of land or securitized mortgages.

22. Mr. DOYLE (Observer for Ireland) said that an inclusive list would contradict the idea that the draft Convention should have the widest possible scope. Also, the Commission could never be certain that it had included everything that was needed.

23. He shared the view of the Japanese delegation that transactions should either be excluded or not excluded from the draft Convention as a whole, and that the list of exclusions should therefore be added to article 4.

24. In relation to the exclusions from article 11, he agreed with the comment by Mr. Bazinas that article 5 should be worded so that articles 11 and 12 applied only to assignments of trade receivables.

25. Finally, with regard to land, he was not aware that any consensus had been reached. His own delegations favoured the broadest possible exclusion.

26. Mr. STOUFFLET (France) agreed that many national legislations imposed restrictions on sales of land and real estate to foreigners. With regard to the issue raised by the representative of Romania, he noted that the draft Convention dealt only with assignment of receivables arising from the sale of real estate. The sale existed only if the competent law recognized the validity of the contract of sale.

27. If the Commission were to add the exceptions listed by the ad hoc group to those already included in article 4, the list would be rather varied, including consumers together with extremely sophisticated financial institutions. That was a practical and acceptable solution, although not very elegant in terms of style.

28. Regarding the extent of the exclusions, multiple options (complete exclusion, exclusion from the application of articles 11 and 12, and exclusion from the application of texts on priority) would make the draft Convention too complicated. For practical purposes, his delegation would support complete exclusion, in a concern to give as wide a scope as possible to the draft Convention. If article 4 (1) was to contain a general exclusion formula, a list of receivables subject to the draft Convention could be given in the commentary.

29. Mr. SCHNEIDER (Germany) said that his delegation had no difficulty with assignments of receivables arising from the sale of land appearing on the list of exclusions, but was concerned about receivables secured by mortgages on land.

30. There were three different concepts in the various domestic laws on mortgages. Under one concept, the transfer of a receivable secured by a mortgage meant that the mortgage followed the transfer of the receivable. Under another concept, the receivable would follow the transfer of a mortgage. A third concept was that the mortgage was not an accessory right, so that the receivable could be transferred without transferring the mortgage. In the latter case, a loan might be transferred, but the mortgage would not follow. However, there would be an obligation in the underlying contract to transfer the mortgage. Thus different rules would be applied: the transfer of the mortgage would be dealt with under domestic law, and the transfer of the receivable would be dealt with under the draft Convention. Whatever concept or combination thereof was adopted, assignments of receivable secured by mortgages on land should appear on the list for exclusion from the draft Convention. A general exclusion under article 4 (1) would be preferable; if that was not acceptable, he would wish to retain article 4 (2) so that Germany could exclude such receivables under that article or under article 39.

31. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) noted that, if the proprietary effects of an assignment of a receivable relating to real estate were governed by the law of the location of the real estate transfer, they could not then be subject to any other law. With reference to the problem raised by the representative of Romania, it should be made clear that the draft Convention would not affect the rules of public policy with regard to, in particular, transfers of real estate. He wondered whether the different choice of law rule would meet the concerns of the Commission in that respect.

32. Ms. McMILLAN (United Kingdom) said that total exclusion from the Convention was the simplest method and the easiest to justify in terms of presentation and practice, as certain transactions in receivables were totally outside the scope of the draft Convention.

33. With regard to land, her delegation's concerns could be met in article 11. It would be difficult to persuade the United Kingdom authorities that there was any justification for excluding assignments of receivables arising from the sale of land while including assignments of receivables arising from the lease of land: leases in the United Kingdom often covered such a long time period that there was very little difference between a sale and a lease of land. Any interference with the national regime of land registration that governed priority would be extremely difficult to justify, and could make the draft Convention unacceptable to the authorities of her country. The Commission should consider the total exclusion of assignments of receivables arising from transactions in land. Articles 4 (2) and 39 weakened the Convention, as one would always need to check the status of different contracting States with regard to exclusions. A clear text that could be adopted or rejected was far preferable to a text that could be adopted with reservations.

34. Ms. STRAGANZ (Austria) was against the idea of an inclusive list. Any exclusion should be total, and she supported the views expressed by the German delegation in favour of the total exclusion of real estate under article 4 (1). She also shared the United Kingdom view that articles 4 (2) and 39 would result in a lack of transparency and thus weaken the Convention.

35. Ms. WALSH (Observer for Canada) recalled her earlier suggestion that the problem of assignments of receivables secured by an interest in land or arising from the lease or sale of land might be dealt with by a choice of law approach in article 24, which would preserve application of the law of the State in which the land was located. That approach would deal with the rare case of a conflict arising between an assignee of a land-related receivable and a person who had an interest in the relevant land.

36. Mr. AL-SAIDI (Observer for Kuwait) said that assignments of receivables arising under bank deposit relationships (subparagraph (C) of the ad hoc group's proposal) should not be

excluded from the scope of the draft Convention since the bank might also be a debtor. The setting of limits on bank deposits was better left to the parties concerned.

37. In reference to subparagraph (E), he noted that some States did not allow foreigners to acquire real estate; the Secretary of the Working Group on International Contract Practices had been very clear in his comments on that matter.

38. Ms. WALSH (Observer for Canada) proposed the following addition to article 24: "If the assigned receivable arises from the sale or lease of an interest in land, or is secured by such an interest, the rights of the assignee are subject to any competing rights of a person who holds an interest in the land under the law of the State in which the land is situated."

39. Mr. IKEDA (Japan) said that he would prefer not to amend the current text of article 24; it would be better to seek a solution in articles 4, 6, 11 and 12.

40. Mr. AKAM AKAM (Cameroon) agreed with the representative of Japan.

The meeting was suspended at 11.30 a.m. and resumed at 12.15 p.m.

41. Mr. DESCHAMPS (Observer for Canada) explained that the exclusion of assignments of receivables secured by real estate mortgages would cause problems. Business loans were often syndicated and secured not only by the company's stock and receivables, but also by a mortgage on real estate. Thus, it would be arbitrary to exclude assignment of a receivable merely because it was secured by real estate. Furthermore, if an unsecured receivable was assigned and the debtor was later given a mortgage, the receivable would have been covered by the draft Convention at the time of assignment but would cease to be covered once the mortgage was taken out. To give yet another example, the comprehensive assignment of a company's trade receivables to a bank, which would be covered by the draft Convention, would fall outside the provisions of that instrument if the company issued a mortgage to its own clients since companies, in assigning their receivables to a bank as security, nevertheless retained the right to handle them.

42. Under the proposed text, when the assignment of receivables was secured by real estate, the provisions of the draft Convention (the law of the assignor's location) would apply. However, if the assignor assigned the receivable to a third party who would have priority under real estate law, that law would take priority in case of conflict.

43. Mr. KUHN (Observer for Switzerland) said that he strongly supported the Canadian proposal.

44. Mr. MORÁN BOVIO (Spain) said that some years previously Spain had established a new real estate regime similar to that of the United States and Canada. Under that regime, real estate companies could sell receivables in the form of mortgages; such securitization provided a major source of financing for those companies. Thus, his delegation was categorically opposed to the exclusion of assignments of receivables arising from mortgages or the sale of land, and his Government would be unable to ratify the draft Convention if it contained such a provision.

45. Possible solutions, which were not mutually exclusive, would include: the deletion of all reference to real estate from the list of exclusions; the adoption of the Canadian proposal; or the lodging of reservations to those provisions by the States parties concerned.

46. Mr. DOYLE (Observer for Ireland) said that the Commission appeared to have reached an impasse. Therefore, while he would prefer the outright exclusion of real estate from the draft Convention, he was prepared to accept the Canadian proposal as a means of avoiding multiple reservations to the draft Convention upon its adoption.

47. Mr. WHITELEY (United Kingdom) said that he agreed with the delegations of Japan and France that article 24 might not be the best place for the rule in question. Also, it would be better to make an affirmative statement establishing that the location of real estate governed all matters relating to it. The solution might be to incorporate into article 25 a statement to the effect that, in such cases, priority should be given not to the law of the assignor's location, but to that of the jurisdiction in which the land was located.

48. Mr. STOUFFLET (France) said that the Canadian proposal might not fully meet the concerns raised by the Spanish delegation since, although it dealt with the matter of priority, it ignored the issue of foreign-owned mortgages on real estate located in the countries in question. Perhaps the wording of that proposal could be expanded along the lines indicated by the United Kingdom representative.

49. Mr. BERNER (Observer for the Association of the Bar of the City of New York) said that the securitization of mortgages, which had been introduced 20 years earlier, had had a dramatic effect on home ownership in the United States: mortgage rates were lower and more people owned houses than ever before. The draft Convention would go a long way towards extending those benefits to other parts of the world, particularly through the international recognition of bulk receivables. Adoption of the Canadian proposal would serve to improve the draft Convention still further; and there was no danger that practitioners would ignore local rules or sensibilities concerning real estate. It was immaterial, from his point of view, whether the relevant provision appeared in article 24 or article 25.

50. Mr. AL-NASSER (Observer for Saudi Arabia) said that the Canadian proposal—which he preferred to that of the United Kingdom—provided a good basis for a compromise that took account of the concerns expressed by delegations whose national legislation differed as widely as that of Romania and Spain. Foreigners were not permitted to acquire or own real estate in his country, either; there was no question but that the law of the State where the real estate was situated should apply.

51. Mr. HERRMANN (Secretary of the Commission) hoped that the representative of Romania could clarify what in the draft Convention she found unacceptable. Romania barred foreign ownership and other countries placed limitations on it; but there was no contradiction between that position and the draft Convention. By definition, such countries would have no receivables which were owned by foreigners and thus subject to the draft Convention. A similar problem had arisen in relation to previous Commission texts, for example concerning the validity of transactions. National law, however, was paramount; if it excluded a particular practice, all other provisions were irrelevant. The concept of inclusion did not mean that all practices that were not excluded were valid in all circumstances. On the narrower question of receivables relating to real estate held by a Romanian national and assigned to another Romanian national, the provisions on priority in article 24 might be helpful.

52. Ms. GAVRILESCU (Romania) emphasized that the aim of her delegation was to achieve an outcome satisfactory both to countries which provided for the inclusion of real estate as a receivable and to those which did not. It was, however, important that the draft Convention should contain a provision—preferably

in article 25 rather than article 24—stating that any transaction relating to real estate should be governed by the law of the place where that real estate was situated. In the last resort, it was open to a State to lodge a reservation, as provided for under article 4 (2).

53. The CHAIRMAN invited the representative of the United Kingdom to inform the Commission of the precise terms of his delegation's proposal.

54. Mr. WHITELEY (United Kingdom) said that the text, which should constitute an additional paragraph to draft article 25, should read: "Where the assignment would transfer or create an interest in land, or a receivable arising from such an interest, the law of the State in which the land is located will govern the matters specified in article 24." It would be seen that the proposal was broader in scope than the Canadian proposal, which sought only to determine priorities.

55. Mr. SCHNEIDER (Germany) wished to dispel any impression that, when his delegation expressed concern with regard to any part of the draft Convention, it sought to destroy the markets. On the contrary, in the specific instance, mortgages had been of the utmost benefit to his country and others. The problem, however, was that a choice had to be made between two sets of rules: domestic legislation and the draft Convention. The latter did not apply to the special rules of assignments secured by mortgages, for example, so it was no solution to add new provisions to articles 24 or 25. His preferred solution would be to exclude assignments of such receivables.

56. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that, from the outset, there had been no intention that the draft Convention should override statutory limitations under which real estate could not be assigned to foreigners. Indeed, that position was explicitly set out in document A/CN.9/470, paragraph 84.

57. Mr. BURMAN (United States of America) said that he wished to associate himself with the remarks by the representative of Germany, which expressed precisely why his delegation had suggested a list of exclusions. The issue of real estate was clearly a delicate one, however, and care should be taken in dealing with it. He suggested that the delegations of Canada and the United Kingdom should jointly add more precision to their proposals. The phrase "interest in land", for example, was too vague.

The meeting rose at 1.05 p.m.

Summary record of the 685th Meeting

Friday, 16 June 2000, at 3 p.m.

[A/CN.9/SR.685]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 3.05 p.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.4)

1. The CHAIRMAN invited the Commission to resume its discussion of the proposed exclusion of receivables arising from real estate transactions. There were three proposals before the Commission: the first proposal, made by the United States of America, was to exclude completely any reference to real estate transactions from the draft Convention; the second proposal, made by the observer for Canada, was to take up the issue of real estate transactions, particularly assignments of receivables from lease payments, mortgages and other securities and land, in article 24; the third proposal, made by the representative of the United Kingdom, was to deal with it in article 25.

2. Mr. IKEDA (Japan) said that his delegation agreed with observations made by the representative of Spain. Receivables arising from real estate transactions should be governed by the provisions of article 25 of the Convention, in accordance with the United Kingdom proposal. The comments of the representative of Romania were extremely relevant.

3. Ms. GAVRILESCU (Romania) said that Romania would not oppose the inclusion of the issue of receivables arising from real estate transactions in the Convention if that was the wish of the majority of delegations. The proposal made by the United Kingdom, which essentially included the proposal made by Canada, would enable the greatest number of countries to ratify the Convention. According to that proposal, in situations involving real estate transactions, all operations associated with land or real estate would be governed by the law of the State in which the land or real estate was situated.

4. Mr. BERNER (Observer for the Association of the Bar of the City of New York) said that practitioners would always have recourse to local law when determining rights with respect to the real estate in question. For example, in the United States of America, the power and form of mortgages was governed by state law. When banks securitized their mortgages, they had to deal with mortgages from many different states and to ensure compliance with the law of each state concerned. Banks were unable to change the requirements when they assigned their rights to payment unless they made the appropriate arrangements with the local authorities. The inclusion of real estate transactions in the Convention would help lubricate international mortgage securitization markets without infringing on the right of any sovereign nation to block any application within its borders of the rights concerning real estate.

5. Mr. GHAZIZADEH (Islamic Republic of Iran) said that his delegation supported the exclusion of assignment of receivables in relation to sale or lease of land. In the light of the comments of other delegations that wished to include receivables arising from real estate transactions in the Convention, his delegation had compromised and agreed that the Convention should contain

a clause stating that matters concerning real estate would be governed by the law of the State in which the real estate was situated. His delegation therefore supported the proposal made by the United Kingdom.

6. Mr. DESCHAMPS (Observer for Canada) said that he was not sure whether there was any real opposition between the United Kingdom and Canadian proposals. The Canadian proposal was that the law of the assignor should continue to apply if that law did not interfere with the law of the land. For example, if the law of the State in which the real estate was situated applied in all cases, even if no one was claiming priority under the law of the land, that would mean that an assignee of a receivable secured by a mortgage who had complied with the law of the assignor would not have priority against a trustee in the bankruptcy of the assignor. If an assignor assigned a receivable secured by a mortgage, the assignee who complied with the law of the assignor should have a good right against a trustee in the bankruptcy of the assignor, even if the assignee had not registered the assignment against the land.

7. Ms. WALSH (Observer for Canada) said that, if the competition was between two assignees, both of whom were claiming rights only in the receivable and no rights in the underlying land, the application of the law of the assignor's location under article 24 of the draft Convention was appropriate. Canada's proposal addressed situations in which assignees of receivables came into competition with claimants who were claiming an interest in the land by virtue, typically, of registration in the land registry. The claimant could be a judgement creditor who had registered a judgement or a person who had acquired an interest in land and had registered that interest. In such event, the Canadian proposal would give priority to the holder of an interest in land under the law of the jurisdiction in which the land was situated.

8. Mr. WHITELEY (United Kingdom) said that, in the light of the concerns expressed by Canada, his delegation had reformulated its proposal, which would read:

> "Where a receivable arises from an interest in land or where the assignment of a receivable, or any associated transaction, would create or transfer an interest in land, all matters pertaining to that interest in land will be governed by the law of the State in which that land is located for the purposes of this Convention."

The Commission might wish to change the title of article 25 to read "Public property, preferential rights and land."

9. Mr. MORÁN BOVIO (Spain) said that the Canadian proposal was clearer and more complete than the United Kingdom proposal because it solved the thorny issue of the collision of the interests of two different assignees. The matter would also be dealt with in the most appropriate place in the Convention, namely article 24. His delegation therefore preferred the Canadian proposal.

10. Ms. WALSH (Observer for Canada) said that her delegation would need some time to consider the United Kingdom proposal. There seemed to be a growing consensus in the Commission that many forms of land-related receivables should be covered by the Convention provided that an appropriate means of accommodating land law could be found. The language proposed by the United Kingdom might not capture the idea that the Commission wished to see evolve. She agreed with the representative of Spain that the United Kingdom proposal as currently worded failed to indicate which law would determine priority in the event of a competition between the assignee of a receivable and the holder of an interest in land. Her delegation was also concerned about the wording that referred to a situation in which the assignment of a receivable created or transferred an interest in land. There was some degree of circularity in the United Kingdom proposal that needed to be amended and redressed. Further consultations should be held before the Commission decided on the precise wording of the text.

11. The CHAIRMAN said that the Commission should not concern itself with difficult drafting matters; rather, it should discuss the policies to be reflected in the text of the draft Convention.

12. Ms. GAVRILESCU (Romania) said that the Commission had to decide whether or not the Convention would apply to receivables from real estate transactions. The Commission should clarify that point in article 4 of the Convention, which dealt with exclusions, or in article 25. It even had the possibility of keeping the United Kingdom proposal, provided that agreement was reached on its formulation, and to add, in a second paragraph, the Canadian proposal, with a general reference to the course to be taken in cases of a conflict of laws. In the opinion of her delegation, the Commission should make a close study of the United Kingdom proposal.

13. The CHAIRMAN said that the Commission would suspend its consideration of the proposals until further consultations were held. He invited the Commission to consider the question of how the draft Convention would relate to the preliminary draft Convention and draft Protocols thereto of the International Institute for the Unification of Private Law.

14. Mr. WOOL (Observer for the International Institute for the Unification of Private Law (UNIDROIT)), speaking on behalf of the aviation working group on the UNIDROIT preliminary draft Convention on International Interests in Mobile Equipment and the preliminary draft protocol on matters specific to aircraft equipment (preliminary draft Aircraft Protocol), said that the aviation working group had based its work on two propositions. The first was that the receivables attached to an aircraft financing transaction should be governed by rules set forth in an aircraft-specific instrument, rather than by general receivables and financing rules. The second was that such rules should reflect widespread practices in the field, as well as international instruments on the matter, such as the Geneva Convention on the International Recognition of Rights in Aircraft of 1948.

15. The basic reason for deferring to the UNIDROIT texts was the inextricable link in aircraft financing structures between security rights in the object and the associated receivable, a link that made it necessary for both to be covered by a common legal regime in order to prevent conflict of laws with resulting higher transaction costs and loss of commercial predictability.

16. One of the questions before the Commission was whether conflict between the UNIDROIT and UNCITRAL texts could best be avoided by deference or outright exclusion. Article 36 of the UNCITRAL draft Convention provided for a deference approach in dealing with conflicts with other international agreements, whereby more specific treaties on the subject matter would prevail. However, UNIDROIT believed that a narrow, carefully drafted exclusion, would be a better approach.

17. Many national legal systems already had aircraft-specific legislation, including rules covering assignment. While the UNIDROIT approach, including the creation of an asset-specific international registry, would justify overriding existing specific national regimes and the more general provisions of the Geneva Convention, every effort had been made to follow existing practice in the field. The very broad UNCITRAL approach, which differed in a number of substantive points from international practice in the area of aviation, would not have the same justification.

18. An unsatisfactory interim situation could result from a deference regime between the two draft Conventions. Since it was unclear when either of the two instruments would be ratified, a deference approach might complicate ratification, whereas a clear exclusion would relieve potential signatories of any doubts.

19. A third argument for exclusion was that a deference approach would raise problems of application with regard to scope and timing. The sphere-of-application rules in the UNCITRAL draft Convention were complex and quite different from those in the UNIDROIT text. If parties to the transaction were located in different States, which might be signatories to one or the other or both instruments, predictability as to applicable law would suffer. It would be a great commercial advantage if all aspects of an integrated transaction could be subject to a unitary legal regime.

20. On previous occasions, the Commission had made the very cogent point that the exclusion needed to be as narrow as possible. UNIDROIT had responded by limiting the scope of its draft Convention to airframes, aircraft engines and helicopters; railway rolling stock; and space property. Any exclusion should, of course, be carefully worded to avoid an application wider than intended. UNIDROIT had also taken to heart the comments that care should be taken to ensure that the priority rule in its preliminary draft Convention was fair and balanced, and a sub-group was working on that point.

21. Mr. STITES (Observer for the International Institute for the Unification of Private Law (UNIDROIT)), speaking on behalf of the space working group, said that, as currently drafted, the principal features of the preliminary draft protocol on matters specific to space property (preliminary draft Space Property Protocol) included a definition of space property; a categorization of international interests in space property; incorporation of "associated rights" with respect to space property remedy provisions; the liabilities and immunities of the contemplated international registry; treatment of non-consensual and prospective interests in space property; and specific and/or expedited remedies upon default by an obligor.

22. The current draft embodied many practical features absent from existing international instruments affecting security interests in mobile equipment. Key among them was the incorporation of "associated rights" with respect to the enforcement of security interests, for example, in an orbiting satellite. Without those "associated rights", such as the government authorizations and intellectual property rights needed to control and operate the satellite, the commercial value of the satellite as collateral would be much reduced. From an obligee's perspective, a satellite and its "associated rights" functioned as a single asset.

23. None of the existing relevant treaties and conventions effectively addressed the international registration, recognition and enforcement of security interests in space property. Even the UNIDROIT Convention on International Financial Leasing, when applied to space property, had serious shortcomings in terms of scope and remedies. The space sector could benefit greatly from a uniform, predictable and commercially oriented regime governing security interests in space property. That was precisely the aim of the UNIDROIT preliminary draft Convention and Protocol.

24. Mr. KRONKE (Observer for the International Institute for the Unification of Private Law (UNIDROIT)) said that UNIDROIT had developed some suggested language for an exclusion that the Commission might wish to consider. The first words would be either "assignment of rights" or "rights to payment", followed by the phrase "arising from transactions in which mobile equipment is leased or is the primary real security for obligations incurred". Mobile equipment would then be defined as it was in the UNIDROIT text, namely, "airframes, aircraft engines and helicopters; railway rolling stock; and space property".

25. Mr. BURMAN (United States of America) said he thought that the suggested exclusion was appropriately narrow. The three categories mentioned constituted a highly specialized area of equipment financing. The UNIDROIT draft Convention contained rules more closely tailored to the specific practices of the industries in question than the Commission's more general draft Convention could do. There were some major points of difference between the two draft Conventions. UNIDROIT, for example, had taken a substantive-law approach in many areas where the Commission had decided against that approach. Possible conflicts between the two could be better avoided through an exclusion than through a deference provision.

26. Mr. MORÁN BOVIO (Spain) said that it had been his Government's position, as expressed in document A/CN.9/472/Add.2, that article 36 of the draft Convention would suffice to address the relationship with other international texts and that it was not necessary to make specific reference to the UNIDROIT text, because the two draft Conventions dealt with very different spheres, especially with respect to the nature of the financing vehicles utilized.

27. However, the reason given for UNIDROIT's request for an exclusion was similar to those that had been adduced for the other exclusions proposed, namely, the existence of highly specialized, sophisticated markets with their own distinctive systems of financing. From that perspective, an exclusion might well appear to be the most reasonable solution.

28. Nonetheless, there was a problem in adopting the precise formula suggested by UNIDROIT, because its text had not yet been adopted, and none of the wording was yet fixed, including the definition of mobile equipment. Either a broader formula must be sought or the exclusion must be left in brackets until the very last moment to see what developed with the UNIDROIT draft Convention and Protocols.

29. The CHAIRMAN noted that if the Commission followed Spain's suggestion, it would be unable to adopt a draft during the present session. He would like to ask UNIDROIT whether it could provide a definition of "space property".

30. Mr. STITES (Observer for the International Institute for the Unification of Private Law (UNIDROIT)) said that he would consult with the other members of the space working group and endeavour to come up with an answer in the form of a memorandum to be sent to the Commission.

31. Mr. ATWOOD (Australia) said that his delegation's previous concerns about the uncertain scope of the term "mobile equipment" had been largely allayed by the specification of the three categories of aircraft equipment, space property and railway rolling stock. His delegation agreed with the exclusion approach, and its initial impression was that it could approve the language suggested.

32. Mr. STOUFFLET (France) said that he agreed with the representative of Spain that the timing was awkward, since neither draft had been finally adopted. He wished to raise another point, namely, that the purpose of the two draft Conventions was not quite the same. One aimed at facilitating the financing of the acquisition or construction of a few specific categories of objects such as aircraft. The other sought to elaborate a method of financing through assignment of receivables that would be suitable for far wider application.

33. A complete exclusion of any transactions having to do with the defined categories of goods might not be justified. Supposing a company owned an aircraft and had paid for it in full, and supposing the company wished to assign its receivables from operation of the aircraft to finance some other investment, he wondered whether that assignment should fall outside the draft Convention. Perhaps there was another way of relating the two texts, such as leaving the parties a choice between the two regimes, depending on the purpose of the assignment.

34. Mr. BURMAN (United States of America) said that, with regard to the point raised by France, he would like to know from the UNIDROIT observers whether they distinguished between receivables that were inextricably associated with the equipment, "fused" in the jargon of the trade, and other receivables.

35. He would also like to point out, however, that the problem was not simply one of deferring to the UNIDROIT draft Convention. When or even whether the UNIDROIT draft Convention and draft Protocols were adopted was a secondary issue. The point was that a well-established, highly developed set of practices already existed in the industry, and, essentially, the provisions contained in the preliminary draft Aircraft Protocol, for instance, did no more than give expression to what was already the reality and should be accommodated.

The meeting was suspended at 4.40 p.m. and resumed at 5.05 p.m.

36. Mr. HERRMANN (Secretary of the Commission), recalling that UNIDROIT had originally requested exclusion of receivables relating to mobile equipment but had recently decided on a compromise proposal, asked the Secretary-General of UNIDROIT for full information on what that proposal included in addition to a refined structuring of priorities.

37. Mr. WOOL (Observer for the International Institute for the Unification of Private Law (UNIDROIT)) said that, after consultations with a number of delegations, it had been decided to avoid possible conflicts of law and the other legal problems that would arise if one took the deference approach, by opting instead for the clear, narrow exclusion drafted by the Secretary-General of UNIDROIT, which balanced the industries' need for simplicity and predictability with the desire to minimize the impact on the text.

38. Mr. SCHNEIDER (Germany) said that the Commission needed more time to consider the repercussions of the three alternatives: an exclusion under article 4, a rule under article 36 or a rule under articles 24 and 25.

39. His delegation was pleased that the term "mobile equipment" was now well defined but wondered whether there were other relevant objects, for example, as a result of proposals by the International Maritime Organization regarding ships. The Commission should probably draft a general rule that was not dependent on the wording of the UNIDROIT draft Convention; but nothing should be done until it had the final UNIDROIT text.

40. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that he was not aware of a conflict with any other Convention or any request for exclusion of ships or other mobile equipment. The issue was one of substantive law rather than conflict of texts and involved determining whether the assignment of receivables arising from the sale of high-value equipment be subject to the UNCITRAL draft Convention.

41. Mr. KRONKE (Observer for the International Institute for the Unification of Private Law (UNIDROIT)) said that UNIDROIT had taken into consideration the fact that the shipbuilding industry had no interest in being covered by its draft Convention. It had therefore been easy to establish a very short list of three items and to draft three protocols on aircraft equipment, space objects and railway rolling stock. The three corresponding working groups were not planning to expand their scope.

42. Mr. BURMAN (United States of America) said that, since the aircraft industry was highly specialized and its practices did not depend on the UNIDROIT draft Convention but rather were reflected in it, the question of exclusions for aircraft should be dealt with on its merits by the Commission and only secondarily in terms of the UNIDROIT draft Convention, especially since the latter was now confined to three narrow areas of equipment. Also, other aircraft conventions applied to some of the same issues, especially aircraft trusts and rights-in-trusts, with which even the United States would have a problem. His delegation liked the preliminary language suggested to the Commission, which the Drafting Committee should now review.

43. Ms. McMILLAN (United Kingdom) asked which Convention would take precedence in the event of assignment of a large bundle of receivables, some of which fell under the UNIDROIT Convention and some under the UNCITRAL Convention. Could such a collision between the two instruments ever occur and would the substance of the transaction be the deciding factor? The reference in the UNIDROIT proposed wording to "primary real security" in relation to mobile equipment suggested that there might theoretically be a secondary real security that was not mobile equipment.

44. Ms. WALSH (Observer for Canada) said that her understanding of the exception was that all receivables relating to mobile equipment would fall outside the UNCITRAL Convention whether or not a State had ratified the UNIDROIT Convention. She asked a UNIDROIT representative to give the Commission a general policy reason why such receivables were not appropriate to the UNCITRAL Convention.

45. The CHAIRMAN observed that several delegations had made the same point, namely, that, regardless of a UNIDROIT Convention, such receivables would be excluded because of their highly specific nature.

46. Mr. KRONKE (Observer for the International Institute for the Unification of Private Law (UNIDROIT)), replying to the United Kingdom representative and the observer for Canada, said that the proposed UNIDROIT formulation had referred only to primary real security because the exclusion should be as limited as possible, although, of course, there could be other elements in credit financing of the piece of mobile equipment in question. The subject of the exclusion was specifically acquisition, which the UNIDROIT wording had covered in one phrase encompassing lease or retention of title and transfer of ownership under a securities agreement. Only receivables arising from such transactions should be excluded, rather than all possible theoretical or practical receivables related to a piece of mobile equipment. Unless receivables fell under the definition of associated rights, they had no place in the UNIDROIT draft Convention.

47. Mr. BURMAN (United States of America) urged caution in suggesting that there was no need to pay attention simply because a large and well-functioning equipment industry chose to be governed by certain rules. It had been helpful to his own delegation to read a number of statements by the International Air Transport Association (IATA), an agency that spoke for major airlines in over 140 countries. IATA had cited the airline viewpoint that aircraft equipment financing should be governed by certain rules. Delegations seeking more information might

find it useful to contact IATA representatives in their own countries for elucidation.

48. The CHAIRMAN observed that there seemed to be strong support for having an exclusion clause in the UNCITRAL Convention, based on the language UNIDROIT had used. The Commission would revert to the question when the UNIDROIT text had been completed.

49. Turning to another issue, he recalled that there was very strong support in the Commission for including in the draft Convention receivables arising from real estate transactions, but subject to the special rule that the law applicable would be the law of the location of the land. Two proposals had been made: the observer for Canada had suggested an article 24 approach, in which case the rule would apply only in instances of the competing priorities envisaged; whereas the United Kingdom representative had suggested a broader approach under article 25, so that all matters pertaining to such receivables would be covered by the rule. The two delegations had been asked to attempt to reconcile their positions.

50. Ms. McMILLAN (United Kingdom) said that more time was required to draft a proposal.

51. The CHAIRMAN suggested that the Commission should revert to the list of proposed exclusions, which had now been decided upon, and consider how it related to variant B in draft article 5. That implied considering how to define the receivables which fell within the scope of the draft Convention. Some delegations were unhappy with the term "trade receivables".

52. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) asked whether the Commission was expected to consider a definition of trade receivables or to clarify the distinction between financial and trade receivables.

53. The CHAIRMAN said that the present issue was how to deal with variant B, since the list of exclusions was now largely settled, and there was no desire for a list of inclusions.

54. Mr. FRANKEN (Germany) observed that draft article 6 *(c)* contained a definition of receivables financing, draft article 6 (l) defined trade receivables. Variant B of draft article 5 referred to "receivables other than trade receivables". In seeking to define receivables, the Commission could rely on the definition proposed by the United States delegation of a receivable as "a contractual right to payment of a monetary sum owed by a person [debtor] to another person [assignor]". That could be the starting-point for a subsequent definition of trade receivables.

55. Mr. WINSHIP (United States of America) said that that definition had originated from draft article 2 of the existing text of the Convention. The question now to be decided was whether the Commission wished to exclude particular assignments or receivables altogether from the scope of the Convention, or whether the Convention rules would apply to them subject only to the limitation implicit in draft article 5, variant B, that the anti-assignment provisions did not apply to those transactions. Alternatively, should all the Convention's provisions apply to those industries? In the case of deposit accounts, it had to be decided whether they should be excluded altogether, or whether the Convention rules should apply to them subject only to the exclusions in draft articles 11 and 12. Otherwise, they could be included as general receivables, no exception being made for them.

56. The CHAIRMAN said that since the list of exclusions had been settled, it had only to be decided in each case whether the exclusions should be total, or as defined in draft article 6, article 5, variant B, or otherwise. However, the Commission must first be clear on the general scope of the draft Convention.

57. Mr. STOUFFLET (France) doubted whether the distinction between trade receivables and financial receivables was still valid, given that the financial receivables to be excluded were now covered in an agreed list.

58. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) said that the definition of trade receivables in draft article 6 was somewhat narrow. The list proposed by the United States delegation showed that some receivables which were the object of financing had been left out, such as receivables arising under an original contract for intellectual property leases or computer software. Provision should be made, at least in the commentary, for such receivables to be covered by the Convention.

59. Mr. DOYLE (Observer for Ireland) suggested that the Commission should examine the list of proposed exclusions and decide in each case whether the exclusion should apply outright, which would make it an article 4 exclusion, or only for the purposes of draft articles 11 and 12. Draft article 6 should be reformulated to include a definition of receivables, which at present appeared only in draft article 2.

60. Mr. SALINGER (Observer for Factors Chain International (FCI)) said that if article 5, variant B, was not adopted and there was no definition of trade receivables, and if the list of exclusions proposed by the United States delegation referred only to certain draft articles, there was a further type of receivable which should be excluded from the scope of draft articles 11 and 12. It was not appropriate for receivables owed by an assignee to an assignor of a receivable to be subject to draft articles 11 and 12. If a factor purchased receivables from a supplier of goods and services and paid for them on account, so that a sum remained owing under the factoring agreement, he relied on set-off against that factoring agreement to secure the obligations of his assignor. It was important not to allow interference by a third party, such as a bank, with the availability of that set-off, by taking an assignment of rights under the factoring agreement, without the consent of the factor or the invoice discounter. Unless the rights of set-off were maintained, the risk to the assignor would be very substantially increased. Hence if the Commission did not adopt variant B of draft article 5, that situation should be covered in the list of exclusions.

61. Mr. MORÁN BOVIO (Spain) said there was no need for receivables arising from bank deposits to be wholly excluded; they could be covered by the draft Convention if the debtor consented to the assignment. In that case, they would fall under draft articles 11 and 12.

62. Mr. IKEDA (Japan) said that in reviewing the list of proposed exclusions in the light of draft article 5, variant B, and draft article 6, the Commission should endeavour to ensure that the Convention would remain a convenient and readily applicable instrument. That depended on the kind of exclusions made in draft article 6. If they were partial and subject to limitation, the Convention would become too complicated to apply.

63. Mr. BURMAN (United States of America) was willing to discuss the definition of trade receivables. He agreed with the view expressed by the observer for the European Federation of National Factoring Associations, and added that credit card receivables should be considered for inclusion in the definition of trade receivables.

The meeting rose at 6 p.m.

Summary record of the 686th Meeting

Monday, 19 June 2000, at 10 a.m.

[A/CN.9/SR.686]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.05 a.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.4)

1. Mr. MORÁN BOVIO (Spain) shared the view expressed at a previous meeting by the French delegation that, when work on the list of exclusions had been completed, the Commission would no longer need to maintain a distinction between trade receivables and financial receivables. Article 5 might then be unnecessary. The draft text would be very comprehensive, with just a few receivables excluded under article 4.

2. Mr. IKEDA (Japan) noted that the majority of members wished the draft Convention to have the broadest possible scope and that a degree of predictability and comprehensibility was essential. The style and structure of the draft text should be preserved without significant changes, as the document had already been thoroughly considered by governments.

3. Total exclusion of the list of receivables would excessively limit the scope of the draft Convention. On the other hand, specific partial exclusions could make implementation of the draft Convention very complicated. Variant B of article 5 (A/CN.9/470, para. 49) had obtained majority support in the ad hoc group on exclusions, but its weak point was the reference to "receivables other than trade receivables". That reference made a definition of trade receivables necessary, and could give rise to uncertainty in the future. The exclusion should therefore be made more specific, by inserting the list of excluded receivables in variant B of article 5, while maintaining the rest of the basic structure of the article.

4. He proposed the following wording: "Articles 11 and 12 (and section II of chapter IV) shall not apply to the assignment of receivables enumerated in this article. The matters addressed by these articles should be settled in conformity with the law applicable by virtue of the rules of private international law." The list of excluded receivables would follow. The advantage of that proposal was that the definition of the term "trade receivables" and the list of excluded receivables would not be required in article 6. In addition, it provided the benefit of a specific list. The distinction between total exclusion of certain assignments in article 4 and partial and particular exclusion of certain receivables in article 5 would thus be clear.

5. Mr. DUCAROIR (Observer for the European Banking Federation) welcomed the emerging consensus to the effect that the Commission should not retain the distinction between trade receivables and financial receivables. Also, a majority seemed to prefer not to have a list specifying which receivables were expressly included within the scope of the draft Convention. On the other hand, the positions of the ad hoc group and the Japanese delegation were very different. The ad hoc group was proposing total exclusion, which would be clearer, whereas the Japanese delegation was proposing an interesting adaptation of variant B of article 5. Instead of an ambiguous reference to "receivables other than trade receivables", that delegation was proposing a list of receivables subject to partial exception—exception to articles 11 and 12. Reference was also made in the Japanese proposal, as in the original version of variant B, to section II of chapter IV. That seemed quite unnecessary: in the case of an exception to article 11, taking into account a non-assignability clause, the assignment was not effective, and in that case there was no reason to be concerned with section II of chapter IV. However, that was merely a drafting issue.

6. Mr. COHEN (United States of America) said that his delegation would no longer advocate including a list of receivables to be covered by the draft Convention.

7. Speaking on behalf of the ad hoc group, he said that the group continued to support total exclusion for the six items discussed the previous week. As the observer for the European Banking Federation had pointed out, there was an important difference between total exclusion and exclusion only from the provisions of the draft Convention mentioned in variant B of article 5. If the assignment of one of the excluded receivables was effective, as it might be under domestic law, rules to deal with that receivable were still needed; if the rules of the draft Convention applied, as they would in the absence of an exclusion, those rules would not work well. Many of the rules in the draft Convention, other than those in articles 11 and 12, did not work well in the context of receivables on the list of proposed exclusions. In particular, the rules about representations of the assignor, the priority rules in article 24 and those defining location would all cause difficulty in the case of excluded transactions. For that reason, his delegation would support a list of total exclusions rather than exclusions from only selected provisions.

8. The ad hoc group, consisting of representatives of the United States and Germany and the observer for EUROPA-FACTORING, had considered those issues and proposed that the following new article 4 (2) should be inserted in the Convention:

"(2) This Convention does not apply to assignments of receivables:

(a) Arising from transactions on a regulated exchange;

(b) Arising under financial contracts governed by netting agreements, except a receivable owed on the termination of all outstanding transactions;

(c) Arising from bank deposits;

(d) Arising under inter-bank payments systems or investment securities settlement systems;

(e) Arising under a letter of credit or independent bank guarantee;

(f) Arising from the sale or loan of investment securities."

9. With that list of exclusions in article 4, variant B of article 5 would still have a role in the draft Convention, because there were some transactions still within the scope of the instrument that were not assignments of trade receivables and would therefore need special treatment.

10. The ad hoc group also recommended including in the draft Convention the definition of the term "trade receivable" as contained in article 6 (l), amended to read:

"'Trade receivable' means a receivable:

(i) Arising under an original contract for the sale or lease of goods or the provision of services other than financial services;

(ii) Arising under an original contract for the sale, lease, or licence of industrial or other intellectual property or other information;

(iii) Representing the payment obligation for a credit card transaction."

11. With the addition of the last two items to the definition of "trade receivable", his delegation would suggest the deletion from article 5, variant B, of the words "and section II of chapter IV", as articles 11 and 12 overrode anti-assignment clauses, among other things. If there was an anti-assignment clause, and articles 11 and 12 did not apply, domestic law chosen by the rules of private international law would determine whether the anti-assignment clause was effective. If such a clause was effective under domestic law, then there was no assignment, and application of the draft Convention was not required. If domestic law would not give effect to the anti-assignment clause, and the assignment was effective, then the debtor protection provisions in section II of chapter IV were extremely important. Therefore article 5 should simply state that articles 11 and 12 applied only to assignments of trade receivables. If any receivables were assigned, trade receivables or not, section II of chapter IV should apply.

12. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) asked whether, in the case of assignment of the receivables other than trade receivables referred to in article 5, there were provisions of the draft Convention other than articles 11 and 12 which would not apply.

13. Mr. COHEN (United States of America) said that, with the exception of articles 11 and 12, the draft Convention worked quite well for receivables other than trade receivables. A good example was a loan receivable; that type of receivable would not be excluded from the scope of the draft Convention, and did not fit under the definition of a trade receivable; therefore the rules of the draft Convention, other than articles 11 and 12, would apply. In the case of large syndicated loans, it was very common for the loan agreement to list the eligible assignees.

14. Regarding the reason why the transactions listed in article 4 (2) were not suited to the draft Convention, he said that the problem went beyond the rules on anti-assignment clauses; difficulties arose also with the rules governing the location of banks and priority rules, for example. For each of the six items on the proposed list of exclusions, several provisions of the draft Convention would not work well and would need adjustment; it was therefore proposed that there should be full exclusion for those items, and exclusion from articles 11 and 12 for receivables other than trade receivables.

15. Mr. MORÁN BOVIO (Spain) said that his delegation supported the comments made by EBF about the proposal by the representative of Japan. It also believed that, once the list of exclusions was finalized, there would be no need to retain article 5, because difficulties could arise with some financial receivables, for example loan agreements. Article 5 created two separate groups of receivables—financial receivables and trade receivables—and the distinction between them was not absolutely clear.

16. In the case of receivables arising from bank deposits, he proposed that there should be a provision that they would fall within the scope of the draft Convention if the debtor consented.

17. His delegation felt that it would be better not to include the proposed new paragraphs (ii) and (iii) in the definition of a trade receivable; it was unwise to have an inclusive list of trade receivables, because future developments could not be foreseen.

18. Mr. BERNER (Observer for the Association of the Bar of the City of New York) said that, for practical reasons, the receivables that were excluded from the scope of the draft Convention should be excluded in their entirety. Otherwise, the Commission would have to spend a great deal of time trying to tailor the draft Convention to fit the receivables which were to be partially excluded, or to force those receivables into a draft Convention in which they did not belong. The Commission had already agreed that those receivables would be excluded from a significant portion of the draft Convention; if they were half in and half out, there could be complications in the future if a new convention was to be drafted that would cover them in their entirety.

19. Mr. FRANKEN (Germany) said that his delegation fully supported the ad hoc group's proposal. However, it had proposed the addition of the words "regardless of whether or not governed by netting agreements" at the end of article 4 (2) *(d)*, and the words "including repurchase agreements" at the end of paragraph (2) *(f)*.

20. With regard to the issue raised by the representatives of Japan and Spain concerning the distinction between trade receivables and financial receivables, he said that the proposed new article 4 (2) referred to assignments of receivables, not financial receivables. It might be helpful to delete the words "other than financial services" in article 6, paragraph 1, subparagraph (i).

21. Mr. DOYLE (Observer for Ireland) said that his delegation fully agreed that the exclusions from the scope of the draft Convention should be total exclusions, especially because it would be very difficult to tailor the draft Convention to receivables that were to be partially excluded.

22. The proposal by the representative of Spain to amend article 4 (2) *(c)* would introduce an element of uncertainty into what was a very clear exclusion.

23. His delegation agreed with the representatives of France and Spain that, if article 4 (2) listed all the exclusions that were desired, there would be no need for article 5, since there would no longer be any receivables other than trade receivables that would be covered by the draft Convention.

24. Mr. IKEDA (Japan) said that his delegation was not convinced by the ad hoc group's proposal and was concerned about the relationship between article 4 and article 5. His delegation would have no difficulty with the proposed deletion in article 5. However, when article 4 was finalized, article 5 could be deleted, for the sake of simplicity.

25. Mr. SALINGER (Observer for Factors Chain International) recalled that he had pointed out at the previous meeting that, unless receivables arising from assignment agreements—for example, factoring and invoice discounting receivables—were excluded from the scope of articles 11 and 12, the cost of credit in those types of financial agreements would be considerably increased.

26. His organization strongly supported the proposals of the ad hoc group, provided that factoring agreements, whether for the purpose of financing or for protecting suppliers of goods and services against bad debts, were regarded as financial services.

27. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) suggested that the objective of article 5 could be achieved by a specific list of exclusions from article 11. That would obviate the need to distinguish between financial and trade receivables.

28. Mr. COHEN (United States of America) recalled that, at the meetings of the Working Group held during the Commission's thirty-first session, delegations had tried unsuccessfully to define financial receivables, and there had therefore been an informal consensus to define trade receivables rather than the absence of trade receivables. As long as a clear distinction was drawn between trade receivables and non-trade receivables, that distinction could be used to state a clear rule, which was the sole purpose of article 5. If the Commission felt that article 5 added to the complexity of the draft Convention, it could be deleted, and a phrase could be included in articles 11 and 12 to indicate that those articles did not apply to receivables other than trade receivables.

29. Examples of receivables other than trade receivables which would not be excluded from the scope of the draft Convention were loan receivables, whereby a creditor made a loan to a borrower, and the borrower's obligation to repay was a receivable. Larger loans were likely to be part of a broad participation agreement among creditors. Such receivables would not be excluded from the scope of the draft Convention, and did not fall within the definition of a trade receivable, so that articles 11 and 12 would not apply.

30. His delegation had concerns about the proposal by the representative of Spain for an exception to the exclusion for bank deposits, because there would be two types of consent: consent to an assignment, and consent to be governed by the draft Convention. It was likely that in many cases a bank that was willing to consent to an assignment would not be willing to accept the application of the rules of the draft Convention to that assignment, because that could create a malpractice trap.

31. The amendments proposed by the representative of Germany had not been included because of a suggestion that they were redundant. His delegation would have no objection to including them, but would prefer to retain the phrase "other than financial services" in article 6, for the sake of clarity.

32. The CHAIRMAN said that consensus seemed to be emerging that the exclusions in article 4 should be total exclusions. The Commission needed to decide whether bank deposits would be excluded only from articles 11 and 12, or from the draft Convention as a whole.

33. Mr. MORÁN BOVIO (Spain) said that, with regard to the distinction between trade receivables and financial receivables, it could be said that there was a trade receivable when a merchant assigned a receivable against persons to whom he had sold goods. However, if that receivable was assigned to a financial institution, it was not clear whether it would still be a trade receivable or would be a financial receivable. Difficulties could arise in the case of bank deposit accounts, where the bank was the debtor.

34. Mr. STOUFFLET (France) said that there were situations in which the distinction between trade receivables and financial receivables was not logical. For example, an international sale of a factory could by financed by bank credit to the buyer or the seller, in which case it would be a financial receivable and articles 11 and 12 would not apply; or could be financed by the seller, in which case it would be a trade receivable and, if assigned, covered by articles 11 and 12.

35. Mr. COHEN (United States of America) said that it was his delegation's understanding that a receivable arising under a contract for the sale of goods was a trade receivable, no matter how many times it was assigned.

36. He did not feel that there could be a special exception for banks. His example of syndicated loans was applicable to other financial institutions such as insurance companies. Limiting the rule to specific parties would not be satisfactory.

The meeting was suspended at 11.35 a.m. and resumed at 12.05 p.m.

37. Mr. COHEN (United States of America) said that, following consultations with the representatives of Spain and Japan, the ad hoc group had produced a proposal that he trusted would ease outstanding concerns, particularly in relation to article 5. The simple but effective solution was to delete article 5 altogether and to transfer to articles 11 and 12 much of the wording from the proposed definition of a "trade receivable". Article 6 (l) would be deleted and articles 11 and 12 would each contain the following text: "This article applies only to receivables: (i) arising under an original contract for the sale or lease of goods or the provision of services other than financial services; (ii) arising under an original contract for the sale, lease or licence of industrial or other intellectual property or other information; (iii) representing the payment obligation for a credit card transaction." He recognized the clumsiness of introducing the same text into two articles, but that approach had the advantage of bringing an important rule to the reader's attention at the appropriate point. Transferring the text had the additional benefit of giving the Commission time to refine the partial exclusions under those articles.

38. The CHAIRMAN noted that the proposal met the concern of some delegations that providing a definition of trade receivables as distinct from financial receivables might unduly complicate the text of the draft Convention.

39. Mr. SALINGER (Observer for Factors Chain International) hoped that the proposal would be accepted. He retained doubts, however, concerning articles 11 and 12 and reserved the right to explain those doubts during the debate on the articles.

40. Ms. WALSH (Observer for Canada) concurred with that view. Moreover, her delegation would be reluctant to conclude the discussion on the scope of the partial exclusions until the text to be inserted in articles 11 and 12 was finalized in all languages; it was an instance where issues of drafting shaded into issues of substance. One of the questions that remained to be answered was whether the phrase "other than financial services", in the proposed wording of article 6 (i), included credit facility services offered by non-financial institutions.

41. Ms. GAVRILESCU (Romania) supported the proposal, which provided the best response to the concerns that had been expressed.

42. Mr. DOYLE (Observer for Ireland) supported the proposal in principle, although he too wished to see a text before he could

give a final endorsement. He also sought confirmation that the authors of the proposal were of the view that all the exclusions in article 4 should be considered total exclusions.

43. Mr. TELL (France) stressed the need for a working document before any decision could be reached.

44. The CHAIRMAN said that a written text would be required only when articles 11 and 12 came to be discussed. As for article 4, the drafting group would ensure that all the languages were aligned.

45 Mr. MORÁN BOVIO (Spain) endorsed that approach. During the debate on articles 11 and 12 it would be possible to clarify the scope of the non-assignability clauses, for example. He urged delegations to pool their ideas about the ultimate structure of articles 11 and 12; the suggested insertion, welcome though it was, constituted only an interim solution and the articles would need some recasting if the full effect of the insertion was to be achieved.

46. He expressed concern that an absolute exclusion from the draft Convention of assignments of receivables arising from bank deposits could lead to undesirable results for some financial institutions. He suggested the possibility of adding a provision allowing the debtor institution the option of considering the receivable as assignable.

47. Mr. TELL (France) reiterated his delegation's preference for a draft Convention with comprehensive scope. While valid reasons existed for the exclusion of some other categories of receivables, no argument thus far presented had appeared to justify the total exclusion of bank deposits. However, it might be possible for the Commission to consider excluding them from the operation of articles 11 and 12.

48. Mr. DOYLE (Observer for Ireland) said that, while he had previously supported the inclusion of bank deposits, a strong consensus against their inclusion had recently emerged in the Commission. In view of the difficulties to which their inclusion would give rise in connection with several areas of the draft Convention, such as the definition of "location" and the priority rules, it appeared that the draft Convention simply could not be adequately applied to bank deposits. As the United States representative had suggested, even a partial inclusion of bank deposits in the scope of the draft Convention would oblige the Commission to renew its search for ways to address those difficulties.

49. Ms. SABO (Observer for Canada) said that, although her delegation preferred bank deposits to be covered by the draft Convention, it was clear that the question of location with respect to bank deposits could not be resolved to the satisfaction of certain delegations. Absent a resolution of that problem, consensus on the draft Convention could be achieved only by excluding bank deposits entirely.

50. Mr. DUCAROIR (Observer for the European Banking Federation) said that the European banking profession favoured the total exclusion of bank deposits. If a broader consensus could be achieved on the question of location, the European banking profession could accept the exclusion of bank deposits from articles 11 and 12 only.

51. The CHAIRMAN said that the Commission had as yet been unable to formulate a satisfactory definition of location as applied to bank deposits, and that strong support continued to exist for their exclusion. Some delegations had proposed that debtors should be given the option of agreeing to the application of the draft Convention, and that the exclusion of bank deposits should be limited to articles 11 and 12. He suggested that those proposals should be noted and referred to the drafting group, along with the other exclusions thus far agreed. He then drew the attention of the Commission to the original article 4 (2) in document A/CN.9/470, which would enable States to file declarations under article 39 specifically excluding certain receivables from the scope of the draft Convention.

52. Mr. MORÁN BOVIO (Spain) recalled that the original article 4 (2) had been intended to provide a way for those countries that did not fully agree with specific aspects of the draft Convention to avoid the application of those aspects within their borders. The need for such an article had been apparent only before the achievement of a broad consensus on topics to be excluded from the overall scope of the draft Convention. His delegation was therefore of the view that article 4 (2) as proposed should be discarded, because it introduced uncertainty into the application of the draft Convention. Those countries having difficulties with specific provisions of the instrument could try to have those difficulties resolved through debate at the appropriate time, but the Commission should not leave the door open to disharmony and misunderstanding in an area in which it was so close to achieving overall consensus.

53. The CHAIRMAN agreed that the inclusion of the text would mean that the draft Convention would have different spheres of application in different States, leading to uncertainty in its application.

54. Ms. SABO (Observer for Canada) said that her delegation strongly supported the view expressed by the representative of Spain. While hoping for the broadest possible application of the draft Convention, her delegation preferred to have any limitations on the instrument's scope agreed within the Commission rather than added piecemeal by States during the ratification process.

55. Ms. GAVRILESCU (Romania) said that her delegation saw a need to include the proposed article, which was intended to enhance the draft Convention's likelihood of ratification by the greatest number of countries by establishing a procedure for them to enter any reservations they might have regarding that instrument.

56. Ms. LADOVÁ (Observer for the Czech Republic) said that, as her country was in the process of harmonizing its legislation with that of the European Union, the law restricting the acquisition of real estate by foreigners would be eliminated. Her delegation therefore supported the inclusion of article 4 (2) as proposed.

57. Mr. DOYLE (Observer for Ireland) said that the proposed article 4 (2) should be deleted, as suggested by the representative of Spain. The emerging consensus on the matter of the draft Convention's scope eliminated the need for the proposed paragraph, while its continued inclusion presented the positive danger of allowing uncertainty in the draft Convention. Its deletion, on the other hand, would probably entail the need to delete article 39 as well.

58. Mr. TELL (France) said that the draft Convention's scope of application was being eroded by the increasing number of exclusions. It would be better to avoid the inclusion of articles such as 4 (2) and 39, whose effect would be seriously to impair the uniformity, and thus the effectiveness, of the draft Convention.

The meeting rose at 1 p.m.

Summary record of the 687th Meeting

Monday, 19 June 2000, at 3 p.m.

[A/CN.9/SR.687]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 3.10 p.m.

ELECTION OF OFFICERS *(continued)*

1. Mr. FERRARI (Italy) nominated Mr. Morán Bovio (Spain) for the office of Rapporteur.

2. Mr. RENGER (Germany), Mr. MARADIAGA (Honduras) and Ms. POSTELNICESCU (Romania) seconded the nomination.

3. *Mr. Morán Bovio (Spain) was elected Rapporteur by acclamation.*

4. Mr. HERRMANN (Secretary of the Commission) said that, since the Chairman and Rapporteur had been drawn, respectively, from the Groups of Asian and Western European and other States, the Groups of Latin American and Caribbean, African and Eastern European States should hold consultations and nominate the three Vice-Chairmen.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.4)

5. The CHAIRMAN recalled that there had been strong support at the previous meeting for the deletion of original article 4 (2) of the draft Convention, which corresponded to square-bracketed article 4 (3) in the draft report of the ad hoc group introduced at that same meeting.

6. Mr. MARADIAGA (Honduras) said that he supported the statements made by the Spanish and French representatives at the previous meeting, since the main goal of the draft Convention was to unify law.

7. Ms. GAVRILESCU (Romania), Ms. MANGKLATANAKUL (Thailand) and Mr. WHITELEY (United Kingdom) said that their delegations were not yet ready to support deletion and suggested that a decision on the matter should be deferred until the issue of the exclusion of receivables arising from real estate transactions had been discussed.

8. The CHAIRMAN accordingly invited the Commission to resume consideration of a definition of interbank payment systems to be included under a revised article 6. The European Banking Federation (EBF) had drafted an article 6 *(m)* defining the term "payments or securities settlement system" as any contractual arrangement between three or more participants (A/CN.9/472/Add.1, p. 12). It would be recalled that the Commission, in connection with its consideration of the report of the ad hoc group concerning exclusions under article 4, had decided that the draft Convention should not apply to receivables arising under interbank payment systems or investment securities settlement systems.

9. Mr. DESCHAMPS (Observer for Canada) asked why a definition of interbank payment systems was needed.

10. Mr. DUCAROIR (European Banking Federation (EBF)) said that the concept of interbank payment systems had already been defined for the member countries of the European Union in a recent EEC glossary directive. After much controversy, it had been decided to confine the definition of interbank payments to arrangements involving three or more participants. Unless the term "interbank payments" was defined, it might be interpreted differently by the various States, according to their practice, which might, for instance, include bilateral correspondent banking.

11. Mr. SMITH (United States of America) said that there were two issues: whether there should be a definition at all; and if so, what the definition should be. The United States was perfectly content not to have a definition, but if the Commission felt it was required, his delegation believed that it should refer to two or more participants rather than three or more. The United States was familiar with two-bank payment systems, either between two banks in the same location which agreed that their debits and credits would be combined, or between a central bank branch and an individual bank. If the criterion was three or more participants, the exclusion of receivables arising from such payments would be too narrow.

12. The CHAIRMAN asked whether, without a definition, the proposed exclusion of receivables arising under interbank payments systems or investment securities settlement systems (draft article 4 (2) *(d)* in the report of the ad hoc group would be clear to all.

13. Mr. SMITH (United States of America) said he thought that it would. The fact that the European Union had adopted a narrower definition for the purposes of European Union community law did not mean that the draft Convention had to follow suit. The commentary to the relevant article could make it clear that the Convention definition was broader than that in European Union law.

14. Mr. DUCAROIR (European Banking Federation (EBF)) said that he would support the United States position since the matter was not of major concern. A clarification in the commentary to the draft Convention would, however, be welcome.

15. Mr. RENGER (Germany) said that the matter was of concern to his delegation. Its understanding was that interbank payments always involved three or more participants. If the Convention introduced two different definitions for a term which by law already had an established meaning in Europe, the European Union countries would find it hard to adopt the Convention.

16. Mr. SMITH (United States of America) said that often terms used in international conventions were defined differently in national law. The search for common formulations made that unavoidable. The purpose of the term used by the ad hoc group in the text of the Convention might well be different from that of the term used to define an interbank payment system in a European Council directive. He guessed that for the European Union

it meant a system where payments were regulated under certain rules among banks and where the concerns were the solvency and systemic risk of the overall banking system. In the Convention, however, it was used merely to exclude assignment of the receivable in question, and the exclusion had been proposed merely because a payment owed by one bank to another was not usually the type of receivable the Convention was designed to address. In many countries, payments between even two banks were subject to other areas of the law, where the Convention was not needed. Bearing in mind those totally different purposes for using the term, it did not seem a problem to the United States to propose exclusion of payments owed by one bank to another if one viewed that as an interbank payment system.

17. Mr. MORÁN BOVIO (Spain) observed that in Europe the system required three or more participants; yet the concrete relationship of the payment was usually bilateral. Since the matter was very technical and could have different interpretations under different legal systems, he supported the position just taken by the European Banking Federation, that it should be left to the commentary to make it clear that the European Union definition was one of several possible ones and explaining what precisely was being excluded from the Convention.

18. Mr. SMITH (United States of America) said that there would be no problem in including the EBF definition in the commentary as one of the systems covered by the term "interbank payment system".

19. Mr. RENGER (Germany) said that his delegation accepted the Spanish suggestion.

20. Mr. HERRMANN (Secretary of the Commission) cautioned against counting on the commentary as an escape hatch by referring all disputed questions to it. There was some question as to whether the final text would include a commentary at all. Draft conventions referred to the General Assembly normally did not, whereas those referred to a diplomatic conference for adoption usually did. Moreover, in the case of the absolutely final text adopted by a conference, the practice had been to consider the commentary official only if the Commission or the conference had approved the text of it as such. In cases where the Commission had asked the General Assembly to act as or in lieu of a diplomatic conference, however, it had not necessarily always prepared a commentary. A further possibility would be to invite the Commission secretariat, together with a few experts, to prepare a commentary after the fact, based on the final text of the Convention, but the degree of authority such a commentary would have remained to be determined.

21. The CHAIRMAN observed that, in any case, the decision had been made not to include the EBF definition of interbank payments in the text of the Convention itself.

22. Mr. COHEN (United States of America) said that the proposed exclusion in article 4 (1) *(b)* dealt with assignments of a negotiable instrument. A negotiable instrument as a materialized right was treated as a thing and, in many respects, the law of the State in which the negotiable instrument was located was considered to be the law that would govern that right. More generally, as a materialized right, the negotiable instrument was often considered to be different from a mere receivable. While most cases involving negotiable instruments would involve delivery and all necessary endorsements, there were some cases in which delivery was made without endorsement and even some in which the agreement to assign was made without actual delivery. In all such cases, the right of the assignee with respect to the negotiable instrument should not be governed by the Convention. The ad hoc group consisting of representatives of the United States and Germany and the observer for EUROPAFACTORING had therefore proposed that article 4 (1) *(b)* should simply read "Of a negotiable instrument".

23. Mr. DESCHAMPS (Observer for Canada) said that the Commission should have time to consider the implications of the proposal and make sure that the new wording did not lead to more exclusions than those intended.

24. Mr. STOUFFLET (France) said that his delegation was in favour of retaining the text of article 4 (1) *(b)* as originally drafted.

25. Mr. RENGER (Germany) said that his delegation agreed in principle with the proposal of the United States delegation. In many cases, negotiable instruments were transferred without endorsement. The use of the words "To the extent made by [through] a negotiable instrument" would be more appropriate. Under German law, the delivery of a negotiable instrument based on a contract was regarded not as an assignment but rather as a transfer of rights, as in the case of the transfer of goods. Therefore, if the wording proposed by the United States delegation was accepted, the Commission should consider amending the chapeau of article 4 (1) to read: "This Convention does not apply to the transfer of rights" or "This Convention does not apply to assignments and/or the transfer of rights".

26. Mr. DOYLE (Observer for Ireland) said that his delegation was in favour of retaining the original text of article 4 (1) *(b)*. The text had been arrived at after many sessions of the Working Group on International Contract Practices and, in view of the Commission's heavy workload, it was not wise to begin making amendments that did not necessarily improve the text. Moreover, it was difficult for the Commission to assess the ramifications of amendments proposed at such short notice.

27. Mr. MORÁN BOVIO (Spain) said that perhaps the amendment proposed by the United States of America was much broader in scope than might appear at first glance. If the requirement of endorsement and delivery was removed from article 4 (1) *(b)*, the scope of the exclusion would surely be much broader.

28. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the Working Group had decided to refer to "assignments" in article 4 (1) *(b)* in order to reflect the meaning of "assignment" as defined in article 2. The reference to "delivery of a negotiable instrument" or "delivery and endorsement" had been intended to reflect the focus on the means by which the negotiable instrument was transferred instead of on the type of the receivable involved, since different legal systems might have a different understanding of a negotiable instrument or a documentary receivable. The words "To the extent made" were meant to reflect the idea that, if the same receivable that existed in the form of a negotiable instrument also existed under a contract and the receivable under the contract was assigned, that assignment should not be excluded.

29. Mr. COHEN (United States of America) said that, in the majority of transactions in which negotiable instruments were assigned, the instruments were assigned with delivery and any necessary endorsement. Therefore, the deletions proposed by his delegation would not dramatically expand the scope of the exclusion but would ensure that it applied in some very important contexts. For example, if an assignor located in the United States of America under the location rules of the Convention owned and possessed a negotiable instrument in France and assigned that negotiable instrument to a person in France but neglected to endorse the instrument, under the Convention the law of the United States would determine priority because the assignor was

located in the United States. While that might be an acceptable rule for tangible rights, it was inconsistent with the general understanding in many States regarding rights to intangible things, such as negotiable instruments. While most negotiable instruments were transferred by delivery with endorsement, in some contexts endorsements were not made, such as in interbank mortgage transfers and, in some cases, transfer was even made without delivery. While that was only one small corner of the negotiable instruments market, his delegation believed that the Convention should deal appropriately—or not at all—with that small corner. The deletions proposed in article 4 (1) *(b)* would remove the language that prevented the exclusion from applying to such assignments.

30. Ms. McMILLAN (United Kingdom) said that her delegation could support the United States proposal since nothing would be lost by deleting the words "To the extent made by the delivery" and "with any necessary endorsement".

31. Mr. DESCHAMPS (Observer for Canada) said that, if the United States proposal was accepted, the assignment of a negotiable instrument would be excluded from the scope of application of the Convention even if there was no negotiation and even if there was no delivery of the instrument. The United States representative had given an example of an assignment made with delivery. Canada was concerned that the exclusion from the Convention of an assignment without negotiation or without delivery might have unintended consequences. The Commission should therefore have more time to consider all the implications of the proposal.

32. The CHAIRMAN said that he would give the Commission more time to study the proposal, which would be taken up again at a subsequent meeting. He invited the Commission to consider article 7 of the draft Convention.

33. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the purpose of article 7 was to recognize the right of parties to derogate from or change by agreement provisions of the Convention relating to their rights as long as the rights of persons not parties to the agreement remained unaffected. The Working Group believed that such an approach was necessary because an agreement under the Convention could affect parties other than the parties to that agreement. For example, an agreement between the assignor and the debtor could affect the assignee, and an agreement between the assignee and the assignor could affect the debtor. The Working Group also believed that the concept reflected in article 7 was in keeping with the general notion of party autonomy, which meant that parties could change their agreement as long as they did not affect the rights of third parties.

34. Under article 21 of the draft Convention, waivers of defences between the assignor and the debtor restricted party autonomy in that such a waiver required a document signed by the debtor so that the debtor was aware of the rights that he was waiving and the consequences of the waiver. The Working Group had decided that, for public policy reasons, certain rights reflected in article 21 (2) should not be subject to a waiver; such rights arose from fraudulent acts on the part of the assignee or defences based on the debtor's incapacity. In the light of that limitation to party autonomy, the Commission might wish to state in article 7 that the rule contained in article 7 was subject to article 21 (2).

35. In considering article 7, the Commission had to decide whether or not agreements between the assignee, the new creditor and the debtor were covered by that article. It was also necessary to clarify whether or not article 7 applied to agreements between the assignee and the debtor to waive the rights of the debtor; that matter could be dealt with in the commentary, as long as the Commission reached an understanding on the subject.

The meeting was suspended at 4.25 p.m and resumed at 5 p.m.

36. The CHAIRMAN invited the Commission to consider article 7 of the draft Convention dealing with party autonomy. He noted that the secretariat, in its commentary (A/CN.9/470), had raised the issue of consistency between article 7 and article 21 and the need to include a specific reference to an agreement between the assignee and the debtor, either in the text of article 7 or in the commentary or report.

37. Mr. MORÁN BOVIO (Spain) said that his delegation felt that a reference to relations between the debtor and the assignee was desirable and should be introduced into the text of article 7 itself. Such a provision would enhance the possibility that, once a debtor received notification of assignment, it could reach an agreement with the assignee, if the parties so desired.

38. Mr. FERRARI (Italy) noted that the wording of article 7 differed from provisions on party autonomy in many other recent commercial law conventions, notably from article 6 of the United Nations Convention on Contracts for the International Sale of Goods, Vienna, 1980, which allowed the parties to opt out of the Convention entirely. That Convention, of course, dealt with two-party transactions, whereas an assignment necessary implied the existence of three parties.

39. Perhaps article 3 of the UNIDROIT Convention on International Factoring, Ottawa, 1988, which dealt with exclusion of the Convention, would be a more appropriate model. It might be useful to allow the parties to exclude the draft Convention, that is, to opt out of it entirely, with, of course, some limitations. They should not, for example, be allowed to derogate from the draft Convention in such a way as to affect the rights of third parties and exclude them from the draft Convention.

40. There were a few other issues that needed clarification. His delegation felt that there were potential problems with the assignor-debtor relationship. Paragraph 75 of the commentary (A/CN.9/470) referred to the possibility that the parties might derogate from the draft Convention by referring to the law of a non-Contracting State or to the domestic law of a Contracting State, but he did not believe that that would actually result in exclusion.

41. With regard to the debtor-assignee relationship, his delegation felt that, if article 7 was left as it stood, it would allow the debtor and the assignee to conclude an agreement excluding the draft Convention, subject to the limitations mentioned in the commentary.

42. Mr. TELL (France) said that, because of the close relationship between the two articles, article 7 should begin with the standard proviso "Without prejudice to the provisions of article 21". He would like to remind the Commission that the Working Group had made the decision not to exclude assignments of consumer receivables or assignment to consumers, as a general rule. Nevertheless, in many countries, consumers were protected by mandatory national law provisions, as was recalled in article 21. He agreed with the Italian representative that the present wording of article 7 would allow a debtor to conclude an agreement with an assignee derogating from the provisions of the draft Convention, a result inconsistent with the provisions of article 21.

43. Without taking a position, for the moment, on the inclusion of a specific reference in article 7 to an agreement between a debtor and an assignee, as suggested by the representative of

Spain, he would merely point out that any such agreement would have to be without prejudice to mandatory law provisions preventing certain classes of debtors from waiving certain rights or defences, and not only those mentioned in article 21.

44. Mr. DOYLE (Observer for Ireland), supported by Mr. BURMAN (United States of America), said he thought that it was too late to take an entirely new approach to article 7. The question raised in paragraph 75 of the commentary (A/CN.9/470) whether article 7 should apply to derogating agreements between the debtor and the assignee had been answered in paragraph 150 of the commentary, which noted that the Working Group had assumed that agreements between assignees and debtors were outside the scope of the draft Convention. If that was the case, then article 7 did not cover such agreements, and there was no need to mention them. Article 7 could stand as currently worded.

45. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that he apologized for any ambiguity in the commentary between paragraphs 75 and 150. It should be borne in mind that, while article 7 and its commentary dealt with any derogating agreements between the parties, article 21 and its commentary dealt with the narrower issue of waivers of defences. What paragraph 150 did make clear was that agreements between the debtor and the assignee whereby the debtor waived certain defences were considered to be outside the scope of the draft Convention and were not covered by article 21. Assuming that such was the correct interpretation, article 7 should be made consistent with it.

46. Mr. FERRARI (Italy) said that there did seem to be a policy difference, since some delegations obviously felt that debtor-assignee agreements should not be covered by the draft Convention at all, whereas his delegation felt that they should be covered except for the waivers of defences mentioned in article 21 (2). Certainly that was the conclusion one must draw from the present wording of article 7, which mentioned the assignor, the assignee and the debtor without drawing distinctions.

47. The CHAIRMAN suggested that the matter of reconciling the two articles, including a proviso along the lines proposed by the French representative, should be left, for the time being, to the drafting group, and the Commission should move on to consideration of article 8 of the draft Convention dealing with principles of interpretation.

48 Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the wording of article 8 had been modelled on similar provisions in other UNCITRAL texts and other international conventions. Paragraph 1 stressed the international character of the draft Convention and the need for uniformity in its application and good faith in international trade. Paragraph 2 addressed the question of matters governed by the draft Convention which were not expressly settled in it and stated that they were to be settled in conformity with its general principles or, in the absence of such principles, in conformity with the rules of private international law.

49. Mr. FERRARI (Italy) said that his delegation supported the policy underlying the article but would like to suggest some modifications. With regard to paragraph 1, the principles contained in the preamble to the draft Convention should be mentioned either in the text itself or in the commentary or report.

50. There was a larger problem with paragraph 2, which could be taken up in conjunction with the consideration of chapter V on conflict of laws. His delegation agreed with the wording as it stood, but not if it was to be extended to chapter V as well. In relation to chapter V, the draft Convention should not allow the creation of private international law by judges. His delegation therefore proposed an amendment to article 8 (2) specifying that it did not extend to chapter V. The amendment could be left in brackets until it was determined whether or not the draft Convention would include chapter V.

51. It might be helpful in the report actually to list the general principles referred to. His delegation, for example, did not consider party autonomy to be one of those principles, whereas it certainly included adequate debtor protection among them.

52. Mr. BURMAN (United States of America) said that his delegation agreed with the Italian proposal regarding article 8 (1). It was important to make specific mention of the preamble, so that other parties who had not been closely involved in the elaboration of the draft Convention would realize its importance for interpretation.

53. Regarding article 8 (2), he shared the concerns expressed by the representative of Italy. There was a need for an amendment stating explicitly that, where a matter governed by the Convention was not expressly settled by it or by the general principles on which it was based, the law applicable as determined by the draft Convention should first be applied and then, as necessary, the law applicable through the general conflicts rules of the jurisdiction concerned. That point could of course be made in the commentary, although the Commission would have to take a decision on the type of commentary it wished to include before deciding whether such a solution would be acceptable. The Commission might want to return to article 8 (2) when it considered chapter V.

54. Ms. KESSEDJIAN (Observer for the Hague Conference on Private International Law) said that, if the provision in question remained as currently drafted, judges charged with its application would refer first to domestic rules of private international law. If those rules led them to apply the law of a State party, they would then refer to the rules of the Convention itself, and, only under those circumstances, would the provisions of chapter V be applied. The Commission must exclude chapter V from the scope of article 8 (2) if indeed it decided to retain that chapter.

55. Mr. AL-NASSER (Observer for Saudi Arabia) said that his delegation agreed that article 8 (2) appeared to call on judges to refer first to domestic rules of private international law.

56. Mr. FERRARI (Italy) pointed out that, in accordance with article 1 (3), the provisions of chapter V applied to assignments of international receivables and to international assignments of receivables as defined in that chapter independently of whether the requirements in article 1 (1) and (2) were met. That being the case, judges should refer directly to the provisions of chapter V, before having recourse to national rules of private international law. However, he agreed that there was a need to distinguish clearly in every instance between the two concepts of private international law provided for in the Convention.

57. Ms. McMILLAN (United Kingdom) said that for those States which, like the United Kingdom, intended to exercise their right under article 37 to opt out of chapter V, the wording of article 8 (2) presented no difficulties.

58. Ms. WALSH (Observer for Canada), noting that Canada also intended to make the declaration under article 37, said that, as she understood it, if a forum State opted out of chapter V, the appropriate rules of international law would be those applicable in that State, whereas, if it did not do so, the appropriate rules would be those contained in chapter V.

59. Regarding the proposed inclusion in article 8 (1) of a reference to the preamble, which her delegation supported in prin-

ciple, it might be prudent to defer a decision on the matter until the wording of the preamble itself had been finalized.

60. Mr. TELL (France) said that his delegation wished to associate itself with the views expressed by the representative of the United Kingdom and the observer for Canada concerning article 8 (2). The problem with the wording was that it assumed that chapter V applied, whereas it was in fact an optional chapter.

61. The CHAIRMAN suggested that the Commission should revert to article 8 (2) when it took up chapter V. As to article 8 (1), one of the fundamental principles of interpretation was that the preamble of any document was intended to assist in its interpretation. However, if the Commission so wished, he would request the drafting group to consider the proposal to include in article 8 (1) a reference to the preamble of the draft Convention.

62. Mr. FERRARI (Italy) said that article 8 (1) must refer specifically to the preamble as one of the elements to be taken into account in interpreting the Convention. The wording of article 4 (1) of the Ottawa Convention might serve as a model.

63. The CHAIRMAN invited the Commission to consider articles 9 and 10 on effectiveness of bulk assignments, assignments of future receivables and partial assignments, and time of assignment respectively.

64. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that he wished to highlight a number of problems with respect to the form of an assignment raised in the analytical commentary to the draft Convention (A/CN.9/470, paras. 80-82). Matters of formal validity were not dealt with in the draft Convention and, while certain matters of material validity were settled in it, others were referred to the law of the assignor's location. As a result, an assignee, in order to establish priority, would first have to establish the formal validity of the assignment. The draft Convention, however, gave no indication as to what law would govern formal validity. The assignee would then have to establish that the assignment was effective between himself and the assignor and, lastly, that he had priority under the law of the assignor's location.

65. There was a need to address those problems in order to simplify the position of assignees. The Working Group, however, had been unable to reach consensus on either a substantive law rule or a private international law rule that would resolve the issue of formal validity. The Commission might wish to include in the draft Convention an applicable law rule dealing with the formal validity of the transfer of proprietary rights in the receivable and to subject that limited issue to the law of the assignor's location, or to establish a "safe harbour" rule to the effect that an assignment was effective if it met at least the form requirements of the law of the State in which the assignor was located.

66. Mr. MORÁN BOVIO (Spain) said that a "safe harbour" rule would represent a most satisfactory solution to the problem of formal validity since it would also address many of the thorny issues raised in paragraph 81 of the commentary. He also welcomed the proposals made in paragraphs 85, 88 and 95.

The meeting rose at 6 p.m.

Summary record of the 688th Meeting

Tuesday, 20 June 2000, at 10 a.m.

[A/CN.9/SR.688]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.05 a.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4)

1. The CHAIRMAN invited the Commission to consider the issue of the form of assignment and noted that some delegations had expressed support for the secretariat proposal concerning a "safe harbour" rule (A/CN.9/470, para. 82).

2. Mr. KUHN (Observer for Switzerland) said that the form of assignment must be addressed in the draft Convention. National legal systems varied in their requirements in that regard; conflict-of-law rules were sometimes lacking or difficult to apply; and the draft Convention must not be open to the interpretation that all assignments, regardless of form, were valid.

3. He therefore welcomed the proposed "safe harbour" rule, which would leave in place the substantive law and private international law rules of States parties; however, the wording suggested by the secretariat could be improved.

4. Mr. BRINK (Observer for EUROPAFACTORING) reminded the Commission that the objective was to validate as many assignments as possible; any uncertainty could lead to an escalation of costs. As the Working Group had been unable to reach consensus on a substantive law rule, he was in favour of the solution proposed by the secretariat.

5. Mr. DOYLE (Observer for Ireland) said that he supported the proposed "safe harbour" rule for the reasons set forth by the previous speakers.

6. Mr. SALINGER (Observer for Factors Chain International) said that any substantive law rule establishing a written form requirement would destroy the usefulness of the draft Convention to the United Kingdom, and doubtless to many other countries as well, since such assignments were subject to a high stamp duty that would make international factoring uneconomical.

7. Ms. WALSH (Observer for Canada) said that, while she supported the proposal for a "safe harbour" rule, she agreed with the observer for Switzerland that the wording of the draft did not cover all potential problems. In particular, the term "form requirements" might not be broad enough. It might be better to include a stronger reference to the law of the State in which the assignor was located, particularly in the case of assignments effective against third parties. Also, it was important to capture the

distinction between the concept of assignment itself and the form requirements for contractive assignment; the latter constituted a vehicle for the transfer of proprietary interests, and some legislations stipulated that they should be submitted in written form or registered publicly.

8. Mr. COHEN (United States of America) said that he did not share the previous speakers' enthusiasm for the idea of including the form of assignment in the draft Convention. Bilateral contracts between assignor and assignee entailed a number of issues which were not dealt with in that instrument and which the Commission had not previously expressed the desire to address.

9. As the observer for Canada had noted, if the issue was raised it must be handled well, whether through a substantive law rule or a "safe harbour" rule; unless carefully drafted, even the latter might lead to the inference that the law of the State in which the assignor was located invariably prevailed. If the Commission was determined to include such a provision, he would prefer as flexible an approach as possible and was therefore prepared to agree to a "safe harbour" rule.

10. Mr. FERRARI (Italy) said that he disagreed with the United States representative; it went without saying that any rule established in the draft Convention must be a good one. In reply to the objection raised by the observer for Factors Chain International, he noted that, like the United Kingdom, Italy imposed a heavy stamp duty on written transactions. However, that did not prevent the Commission from establishing a substantive rule, since in such a case domestic regulations would not apply. Nevertheless, he was in favour of the "safe harbour" rule proposed by the secretariat.

11. Mr. SCHNEIDER (Germany) said that, since the Commission was unlikely to reach consensus on a substantive law rule, his delegation was in favour of the secretariat proposal. However, the italicized words "at least" (A/CN.9/470, para. 82) were unclear and should be deleted. Furthermore, there could be serious repercussions if the words "the State in which the assignor is located" were taken to mean the assignor's place of central administration, which might be in a different State. That problem must be resolved.

12. Mr. DOYLE (Observer for Ireland) agreed with the representative of Germany, that, since the Commission had failed to reach consensus on a substantive law rule, a "safe harbour" rule was the best option. He had no objection to the wording proposed by the secretariat; a rule based on location might not be ideal, but no better solution had been found. He asked the secretariat to explain the words "at least".

13. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the words "at least" had been included to ensure that an assignment was effective if it met the form requirements of the law of the State in which the assignor was located, even if it was not valid under the national legislation of another of the States concerned.

14. Mr. FERRARI (Italy) said that he had interpreted the proposal to mean that, even if the form requirements established under domestic law were met, an assignment would not be effective unless it met those of the State in which the assignor was located. Obviously, the statement must be reworded.

15. Mr. HERRMANN (Secretary of the Commission) referred the Commission to the analytical commentary provided by the secretariat. The proposal was in line with the modern trend in private international law on validity, which was to give several options. Thus, the intent had not been to establish the law of the State in which the assignor was located as a minimum requirement, but rather to create as liberal a regime as possible by adding another option for meeting the standard of effectiveness.

16. Mr. COHEN (United States of America) said that he was prepared to accept the proposal as interpreted by the Secretary of the Commission, subject to its being redrafted for clarity. However, the Working Group had not discussed the term "form", which might not have the same meaning under all national legislations. He assumed that the term included the question whether a written signature was required and, if so, whether electronic signatures were acceptable; however, it also raised issues such as the need for notarial seals, witnesses, notification of third parties, paper size and colour and location of ribbons.

17. Ms. KESSEDJIAN (Observer for the Hague Conference on Private International Law) said that the concerns expressed by the Commission were directly linked to articles 9 and 12 of the 1980 Rome Convention. She did not think that requirements for the effectiveness of assignment as against third parties had ever been considered criteria for formal validity within the meaning of article 9 of that instrument. Her own view was that, for States which interpreted article 12 of the Rome Convention as covering the effectiveness of assignment, article 9 would be deemed to apply to the form of such assignment; however, for States which considered that article 12 did not deal with that issue, it followed that article 9 would not apply.

18. If the secretariat proposal to establish a rule of private international law was adopted, it would be best not to be too specific, to clearly define the term "form" in the draft Convention and to include a limited number of options rather than leaving the draft instrument open to a broad range of interpretations.

19. Mr. STOUFFLET (France) supported the proposed "safe harbour" rule, which would add another option to those provided under international private law.

20. With regard to the issues raised by the observer for the Hague Conference, his delegation considered that the effectiveness of an assignment as against third parties should be dealt with solely as an issue of form since it was already covered in other articles of the draft Convention.

21. Mr. KUHN (Observer for Switzerland) suggested that the words "without prejudice to private international law rules outside of the Convention" should be added to the secretariat proposal. The advantage of the "safe harbour" rule was that it made form requirements subject to the same law—that of the State in which the assignor was located—as articles 24 and 28 (2) of the draft Convention, thereby obviating the need for a clear distinction between form and substance.

22. Mr. IKEDA (Japan) stressed the importance of providing evidence for assignment, whether in written or electronic form. His own country operated a system for establishing priorities, but under the draft Convention, according to the annex to article 3, priority was to be determined on the basis of the date of the contract of assignment. If that provision was retained—and his delegation would prefer that it should not be—it was hard to see how the time of assignment could be proved. There was a danger of fraudulent collusion if a contract was purely oral.

23. Mr. MORÁN BOVIO (Spain) pointed out that many of the concerns raised went beyond the scope of the "safe harbour" rule, which dealt with the specific issue of what form requirements were effective as against third parties. For that purpose, the wording suggested in document A/CN.9/470, paragraph 82, was entirely adequate. He could accept the deletion of the phrase "as against third parties", although he would prefer to retain it; it had the merit of indicating that, once the necessary formalities had been met, they were applicable to all parties.

24. Mr. DOYLE (Observer for Ireland) was also able to accept any of the proposed oral amendments, but thought that there was no point in entering into a long academic debate on interpretation. The Commission should adopt the "safe harbour" rule, along the lines suggested by the secretariat.

25. Mr. BRINK (Observer for EUROPAFACTORING) said that there seemed to be overwhelming support for a "safe harbour" rule which would operate without prejudice to any other private international law. It should be left to the drafting group to produce the best wording. The question of opposability, mentioned by the representative of France, need not be included. Further thought should, however, be given to the difficult matter of location, which impinged on many of the other issues to be settled.

26. Ms. WALSH (Observer for Canada) suggested an alternative wording for the "safe harbour" rule that would allow the application of other rules of private international law to establish validity but would confirm that, if the requirements were complied with, the assignment was valid. The text should read: "An assignment shall be considered formally valid if it meets the formal requirements of the law of the State in which the assignor is located." As the representative of Spain had said, there was no need to distinguish between validity between assignor and assignee and validity against third parties.

27. The CHAIRMAN pointed out that the assignor's location was only one criterion. Other laws might apply to the transaction and it was enough to meet the requirements under any one of them for an assignment to be valid.

28. Mr. HERRMANN (Secretary of the Commission) said that, if the phrase "shall be considered" in the Canadian amendment was intended to indicate a non-exclusive choice of laws, it was too subtle. The issue might be clarified by adding the phrase "or the requirements of the law which determines formal validity according to another applicable rule of private international law". He endorsed, however, the view that further changes should be left to the drafting group.

29. Ms. GAVRILESCU (Romania) concurred. There was clearly general support for the proposal, which should be given its final wording by the Drafting Group. She also noted that, once the Commission had decided that the law of the State in which the assignor was located was applicable, it followed that questions of substance as well as form would be determined under the same law.

30. Mr. MARADIAGA (Honduras) drew attention to paragraph 108 of document A/CN.9/470. When read in conjunction with paragraph 82, it strengthened the case for a "safe harbour" rule and, indeed, gave more force to the draft Convention as a whole.

31. Mr. FERRARI (Italy) said that the Canadian amendment did not provide enough openings for other applicable legislation. A possible solution lay in the way that the Commission had dealt with a similar situation relating to debtors, in article 19, paragraph 6. On that basis, he suggested the following text: "Without prejudice to the formal validity of the assignment on the grounds of any other applicable law, an assignment is effective if it meets the form requirements of the law of the State in which the assignor is located." Paragraph 142 provided a useful commentary on article 19, paragraph 6, and by extension on his proposed amendment.

32. Ms. WALSH (Observer for Canada) suggested that the word "effective" should be replaced by the words "formally valid". The meaning of "effective" was extremely broad; the point should be made that the reference was solely to the validity of the assignment.

33. Mr. FERRARI (Italy) said that he had put forward his amendment with an eye to the Canadian amendment, but the suggested change constituted a further improvement.

34. Ms. GAVRILESCU (Romania) supported the Italian amendment, as subamended by the observer for Canada, since it sought to deal with the concerns that her delegation and others had expressed.

35. Ms. McMILLAN (United Kingdom) suggested a further subamendment: the words "if any" could be inserted after the word "requirements". She also suggested that the word "formal" in the first phrase should be deleted, as being otiose.

36. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the discussion highlighted the need to leave the wording to the drafting group. The expression "without prejudice" had a different meaning in different languages and should be used with caution. Sometimes it almost amounted to the same as "subject to". Indeed, no caveat at all was needed: private international law often offered options but, whichever law was applicable in a given situation, the validity of the assignment remained the same.

37. Mr. SALINGER (Observer for Factors Chain International) expressed bemusement at what seemed an academic debate. It would surely be peculiar if, in relation to the formality of an assignment, rules stricter than those obtaining in the country of the assignor were adopted. Yet under article 24 an assignment was given effect if it accorded with the law of the assignor. It therefore seemed that, as the United States delegation had suggested, no rule was needed at all.

38. The CHAIRMAN said that the "safe harbour" rule had met with firm support and the drafting group should take on its task on that understanding. He encouraged interested delegations, either within the ad hoc group or individually, to submit any further suggestions to the drafting group.

Articles 9 and 10

39. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that articles 9 and 10 should be considered in tandem. Article 9 validated assignments of receivables that otherwise were not specifically identified: bulk assignments, assignments of future receivables and partial assignments. Paragraph (1) *(b)* made no requirement for specific identification of receivables, but they had to be identified as receivables to which the assignment related. Paragraph (2) related to master agreements, with the intention of ensuring that there was no need for a new document with each assignment. He drew particular attention to two aspects of article 9. First, as stated in document A/CN.9/470, paragraph 84, there was no question of the draft Convention overriding statutory limitations in such areas as wages, pensions, real estate receivables, sovereign receivables and many others. The only exceptions were those limitations which sought to invalidate future receivables or bulk receivables as such. The Working Group had therefore suggested the introduction of a new provision on statutory limitations, as reproduced in paragraph 85. Secondly, paragraph 88 contained a suggested clarification of the distinction between effectiveness as between the parties against a debtor and effectiveness as against third parties. Lastly, in connection with article 9, he regretted that an inconsistency with the provisions of article 10 had crept into paragraph 2, in that it suggested that the time of transfer was not the time of assignment but that of the original contract. Such had not been the intention of the Working Group. Article 10 itself concerned the time when a receivable was considered to be transferred. It allowed assignors and assignees to delay a transfer by mutual agreement, including a transfer of future receivables, which in reality did not yet even exist. The commentary on the article, in paragraphs 96 and 97, largely concerned form rather than policy.

The meeting was suspended at 11.25 a.m. and resumed at noon.

40. Mr. ATWOOD (Australia) said that articles 9 and 10 both used the word "transfer" to refer to the concept of assignment; he asked whether that word was synonymous with the word "assignment".

41. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that article 9, paragraph 1, referred to the effectiveness of an assignment, while article 9, paragraph 2, and article 10, referred to a transfer within the meaning of the definition in article 2, namely the creation of rights in receivables as security for indebtedness or other obligation.

42. The CHAIRMAN said that, with regard to statutory limitations on assignments, the wording suggested by the secretariat was to be found in paragraph 85 of the commentary, in document A/CN.9/470. It was a restatement of the concept that the draft Convention was not intended to override statutory limitations on assignability.

43. Mr. SMITH (United States of America) said that that was one of the points his delegation had made in document A/CN.9/472/Add.3. It would support additional language in article 9 to make it clear that statutory limitations on assignment other than those referred to in article 9 were not affected by the draft Convention.

44. Mr. MEDIN (Observer for Sweden) said that, if the draft Convention was not intended to affect any statutory limitations on assignment other than those which followed from article 9, it would be a good idea to state that explicitly in the text. He therefore supported the language formulated by the secretariat.

45. Mr. RENGER (Germany) said that his delegation fully supported the suggestion by the secretariat. However, there could be difficulties with the interpretation of the word "statutory", which seemed to have a different meaning under some legislations.

46. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the intention was to refer to limitations imposed by law, not by contract. It was believed that the term "statutory" would be clear in most cases.

47. Ms. McMILLAN (United Kingdom) noted the suggestion in paragraph 85 of the commentary that there should be a new provision that would read: "This Convention does not affect any statutory limitations on assignment other than those referred to in article 9." Yet there was no reference to statutory limitations in article 9.

48. Mr. DOYLE (Observer for Ireland) said that he understood the intent but that article 9 did not seem to serve its purpose.

49. Mr. MORÁN BOVIO (Spain) said that his delegation fully supported the secretariat suggestion. It was important to have a reference to article 9, even though that article did not expressly refer to statutory limitations. In many countries, there were statutory limitations on assignments of future receivables, bulk assignments, and assignments of parts of receivables; the text put forward by the secretariat was very important because it implicitly stated that under article 9 it would be possible to override those statutory limitations.

50. Mr. SMITH (United States of America) said that his delegation agreed with that point. Similarly, a statute which provided for a contractual restriction on assignment in an original contract, would be inconsistent with articles 11 and 12 of the draft Convention. His delegation therefore believed that the preservation of statutory restrictions on assignments should be taken up by the drafting group so as not to interfere with the existing text of article 9, or the text of articles 11 and 12.

51. The CHAIRMAN said that the matter could be referred to the drafting group.

52. The next issue was effectiveness between the assignor, the assignee and the debtor, as opposed to effectiveness as against third parties.

53. Mr. IKEDA (Japan) sought clarification about the indication in paragraph 84 of the commentary that the draft Convention did not give priority to one creditor over another, but left matters of priority to national law, since in article 10 the rules of priority were based on the time of the conclusion of the contract of assignment. That meant that a future receivable could take priority under the draft Convention or national law.

54. The CHAIRMAN recalled that the secretariat had already indicated that, during the drafting process, an inconsistency had emerged between article 9 and article 10.

55. Mr. MORÁN BOVIO (Spain) said that his delegation fully supported the secretariat's suggestions in paragraph 88 of the commentary, since they improved the text and made it clearer.

56. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the secretariat had felt that it was implicit in articles 11 and 12 that the exception with regard to statutory limitations applied not only to article 9 but also to articles 11 and 12. If it was the wish of the Commission, that point could be made clearer in article 9.

57. With regard to the comments made by the representative of Japan, he recalled that the previous draft of articles 9 and 10 had included wording which made the effectiveness of an assignment subject to the priority rules of the draft Convention. The Working Group had decided to delete that wording, so that, while effectiveness was governed by articles 9 and 10, priority was left to the law of the assignor's location.

58. The purpose of the suggestion in paragraph 88 of the commentary was to make the distinction between effectiveness and priority clearer, and to specify that the effectiveness of an assignment vis-à-vis third parties was left to the law of the assignor's location. It must be ensured that that rule did not extend to the effectiveness of the assignment of future receivables or bulk assignments, which were covered by articles 9 to 12; that was the reason for the second part of the suggestion. The objective, therefore, was to clarify the interplay between effectiveness and priority by ensuring that effectiveness between the assignor and the assignee and as against the debtor was subject to the draft Convention but, with regard to effectiveness as against third parties, priority was left to outside law. A difficulty arose, however, because in some jurisdictions it was not possible to split effectiveness into two parts; the draft Convention therefore needed to be as clear as possible.

59. Mr. WHITELEY (United Kingdom) said that the two issues were distinct under the draft Convention and needed to be treated differently; it was to be hoped that the drafting group would find an appropriate formulation. He wondered whether a jurisdiction that did not recognize effectiveness would be likely to have rules of priority.

60. The CHAIRMAN said that the Commission would need to hear from such jurisdictions if it was to take their concerns into account when formulating the provisions of the draft Convention.

61. Mr. SMITH (United States of America) said that some national jurisdictions, when prohibiting assignments of future receivables or bulk assignments, might not distinguish in their domestic law between effectiveness and priority. If, in such a case, the assignment was effective but priority was left to article 24 of the draft Convention, he wondered how priority would be determined under domestic law. The Working Group had wished to validate bulk assignments and assignments of future receivables, even if that would require a different interpretation or a change

in a national law's priority rules that did not recognize those types of assignment. The secretariat proposal in paragraph 88 was designed to address that issue, and to ensure that a priority rule did not destroy the intent to validate such assignments. His delegation fully endorsed that principle, but found the proposed language imprecise. The United States proposal (A/CN.9/472/Add.3) might address the two issues just discussed, as well as the issue of statutory prohibitions on assignment.

62. Mr. DOYLE (Observer for Ireland) supported the secretariat proposal in paragraph 88, as it did clear up a possible ambiguity. With regard to the jurisdictional question, he entirely agreed with the previous speaker that the intent of that proposal was clear, and the drafting group could therefore take care of the exact wording. However, his delegation was also willing to look at the alternative language proposed by the United States delegation.

63. The CHAIRMAN noted that paragraph 95 of document A/CN.9/470 suggested that the inconsistency between article 9 (2) and article 10 could be resolved by deleting from article 9 (2) the reference to the time of the conclusion of the original contract of assignment. It also suggested the alternative of redrafting paragraph 9 (2) to make the language consistent with that of article 10.

64. Ms. McMILLAN (United Kingdom) said that her delegation supported the proposal to make the language of article 9 (2) consistent with that of article 10.

65. Mr. DOYLE (Observer for Ireland) said that his delegation preferred the simpler solution of deleting from article 9 (2) the reference to the time of conclusion of the original contract, but could also accept the alternative proposal of making the wording consistent with article 10.

66. Mr. MORÁN BOVIO (Spain) preferred to retain the specific reference to the time of conclusion of the contract of assignment, which would make article 9 (2) easier to understand.

67. Mr. RENGER (Germany) requested the secretariat to read out the proposed new wording of article 9 (2).

68. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the text, prior to the last change proposed by the Working Group, read as follows: "Unless otherwise agreed, an assignment of one or more future receivables is effective when it arises without a new act of transfer being required to assign each receivable." However, the reference to the time a receivable arose was not intended to address the time of transfer, which was dealt with more clearly and fully in article 10. Article 9 (2) referred to the stipulation that the receivable had to arise in order for an assignment to be effective at the time, with the time being specified in article 10. It was intended to ensure that master agreements covered future receivables without requiring additional documents. The secretariat therefore preferred to delete the reference to time in article 9 in order to avoid dealing with the same issue in two different articles.

69. With the proposed deletion, article 9 (2) would read: "Unless otherwise agreed, an assignment of one or more future receivables is effective without a new act of transfer being required to assign each receivable."

70. Ms. McMILLAN (United Kingdom) and Ms. WALSH (Observer for Canada) supported the version just proposed by the secretariat.

71. The CHAIRMAN assumed that the Commission accepted the new wording, subject to consideration by the drafting group.

72. Mr. SMITH (United States of America) said that to a large extent his delegation's proposal with regard to effectiveness as against third parties had already been accepted as a matter of policy by the Commission. Article 9 should not render ineffective any statutory prohibitions on assignments. That was reflected in his delegation's proposed article 9 (5) (A/CN.9/472/Add.3). However, a statute that merely validated contractual restrictions on assignment should not interfere with articles 11 and 12.

73. The secretariat had proposed language very similar to his delegation's proposed article 9 (3) to make it clear that article 9 dealt with the effectiveness of the transfer between the assignor and the assignee, but did not affect third parties. Reference had been made to the problem of a statute that did not distinguish between effectiveness and priority when it rendered ineffective bulk assignments and assignments of future receivables. The proposed article 9 (4) also addressed that issue.

74. An additional issue was that national law should not prevent an assignment of future receivables or bulk assignments merely because such assignments could not take place under that law. On the other hand, many insolvency regimes under national law provided for different treatment of post-insolvency receivables. As discussed in the Working Group, in the case of a present assignment of future receivables, if the assignor was subject to insolvency proceedings, the insolvency administrator might have rights under national law to claim an interest in the receivables generated by the assignor after the commencement of those proceedings, even though those receivables had been assigned prior to the insolvency. In order to avoid interfering with national law on the treatment of post-insolvency receivables, his delegation had proposed an additional article 9 (6). According to that paragraph, a general law prohibiting future assignments or bulk assignments would not be recognized under the draft Convention, but an insolvency law with respect to post-insolvency receivables that dealt with priority would still be effective.

75. The CHAIRMAN asked the United States delegation to explain the differences between his proposal and the issues raised in that connection by the secretariat.

76. Ms. WALSH (Observer for Canada) requested clarification from the United States delegation as to the purpose of the proposed paragraph 9 (3).

77. Mr. SMITH (United States of America) said that the proposed paragraph 9 (3) was very similar to the secretariat's proposal. As a general rule, when article 9 referred to transfer, it was referring to the transfer as between the assignor and the assignee and not necessarily in relation to priority, which was left to article 24. The reason for paragraph (3) was the one indicated by the secretariat. The key difference between the proposals related to the extent to which a national law that prohibited the assignment of bulk receivables and future receivables was rendered ineffective by the draft Convention. Such a national law would be rendered ineffective to the extent that it was a general law. However, a law that arose out of the insolvency rules of national law would not be rendered ineffective. The difference was primarily in the preservation of the insolvency rules as to future receivables.

78. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said it was not clear whether the differences were a matter of policy or a drafting issue. Effectiveness was covered only as between the assignor and the assignee and he wondered about effectiveness as against the debtor. Once effectiveness had been limited in that way, he did not see how a rule specifying that the assignment was effective as between the assignor and the assignee, even in the case of post-insolvency receivables, would affect the rights of the insolvency administrator or creditors in insolvency. That matter needed to be further clarified. Perhaps it could be addressed by limiting the effectiveness in article 9 to assignment as between the assignor and the assignee and as against the debtor, as proposed in paragraph 88 of document A/CN.9/470.

The meeting rose at 1.05 p.m.

Summary record of the 689th Meeting

Tuesday, 20 June 2000, at 3 p.m.

[A/CN.9/SR.689]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 3.05 p.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.6)

Article 9 (continued)

1. Mr. SMITH (United States of America), referring to the amendment proposed by his delegation to draft article 9 (A/CN.9/472/Add.3), said that the absence in that amendment of any reference to the debtor did not indicate a difference of policy with the secretariat. The question of the effectiveness of an assignment for the debtor was already covered in the draft Convention, in chapter IV, section II. The key substantive difference between the proposed amendment and the text of draft article 9 in the report of the Working Group (A/CN.9/466) was that the latter text would render an assignment of future receivables and bulk receivables effective against third parties if national law did not do so. However, that would be taking matters too far in the event of an assignment of post-insolvency receivables. The proposal would make clear that, if national law generally failed to recognize an assignment of future and bulk receivables, the assignment would remain effective, but that all other matters relating to priority would continue to be governed by draft article 24. That construction was not evident from the existing text of draft article 9. It was important to draw a careful line between effectiveness and priority, and a reference to the priority rule in draft article 24 would be useful for that purpose.

2. The CHAIRMAN invited the Commission to decide whether it would prefer a more explicit form of words, as proposed by the United States delegation, to express its intention that draft article 9 should apply to post-insolvency receivables.

3. Mr. SCHNEIDER (Germany) thought that the wording proposed by the United States delegation could be misunderstood, giving the impression that an assignment would be effective only between the assignor and the assignee. Draft article 9 should also make clear that it would be effective vis-à-vis the debtor, and there should be no change of policy in that regard. The problem of assignments following the institution of insolvency proceedings should be dealt with by the drafting group.

4. Ms. WALSH (Observer for Canada) said that in referring to an assignment it was important to avoid the term "transfer of a receivable". The language used should cover both transfers and the creation of a security in a receivable, since an assignment might arise by way of hypothecation as well as from a sale. The term "assignment" should therefore replace "transfer" in the United States proposal. Concerning the question of receivables in insolvency proceedings, she would welcome an example of an assignor's law which would illustrate the difference of application between the United States proposal and the Working Group text.

5. Mr. SMITH (United States of America) said that in many jurisdictions insolvency law provided that where an assignor continued to operate a business under court supervision following the institution of insolvency proceedings, the receivables created by the unencumbered assets of its estate were deemed to be the property of the estate and therefore belonged to the creditors. The draft Convention permitted the assignment of bulk and future receivables notwithstanding the provisions of national law, but did not interfere with national insolvency law on the treatment of post-insolvency receivables. However, if a business was being operated under court supervision in insolvency proceedings, an assignee might take the view that it was entitled to all post-insolvency receivables, since the Convention struck down all national laws, including insolvency laws, which prohibited the assignment of future receivables.

6. Ms. WALSH (Observer for Canada) felt that the use of the term "assignment" in place of "transfer" was a substantive question.

7. The CHAIRMAN said that the issue would be referred to the drafting group.

Article 4 (continued)

8. The CHAIRMAN drew attention to the exception for real estate proposed by Canada and the United Kingdom (A/CN.9/XXXIII/CRP.6). Since the text of the proposal was formulated as a separate draft article, it would be appropriate not to include it in the list of exclusions in draft article 4.

9. Mr. WHITELEY (United Kingdom) explained that the proposal was intended to deal with priority issues affecting land, which were otherwise governed by draft article 4, and to preserve the application to all interests in land of the law of the place where the land was situated. The proposal was intended to form a separate draft article, which could replace the former draft article 5.

10. Ms. GAVRILESCU (Romania) was firmly in favour of the proposal. Uniform terminology should be used in the different language versions in referring to land or real estate. The proposal could be entitled "Immovables and the rules of the Convention". Since it was not, properly speaking, an exclusion under draft article 4, it should form a separate draft article.

11. Ms. LADOVÁ (Observer for the Czech Republic) was also in favour of the proposal. She wondered whether it was intended to cover both land and immovables.

12. Mr. DOYLE (Observer for Ireland) supported the proposal, on the understanding that "matters pertaining to" an interest in land would include immovables.

13. Mr. MORÁN BOVIO (Spain) welcomed the proposal, which would help to resolve an important technical question arising from the draft Convention. It could be inserted following the existing draft article 4.

14. Mr. SMITH (United States of America) asked whether the expression "connected with an interest in land" covered a receivable secured by a real-estate mortgage, or one evidenced by a promissory note to which the Convention applied where the real estate was the collateral. Was a right to payment on a sale of land, or a lease on land, a receivable connected with an interest in land" As well as the types of receivable covered by the proposal, it was also necessary to determine who would hold a competing right when the priority was governed by the State where the land was located. He wondered whether, depending on the types of receivables covered by the proposal, the priority rule pointing to the State where the land was located might also need to apply to a competing assignee of the same receivable. If that assignee had an interest in the land because the receivable was secured by the land, or was a lease of the land, would the rule be the right one? The treatment of receivables related to real estate varied from one State to another. If the draft Convention adopted a choice-of-law rule for real-estate receivables, it was necessary to be sure that the treatment of the real-estate receivable under that rule would be acceptable to all the States represented on the Commission. One example of the difficulty would be rents on real estate; in some jurisdictions, priority between competing assignees as to rents was governed by the law of the State where the real estate was located, not the State where the assignor was located. The proposal did not make clear if priority as between competing assignees of leases would be determined under the law of the State where the land was located, or, as prescribed by the general rule of the Convention, under the law of the State of location of the assignor.

15. Mr. SCHNEIDER (Germany) asked whether the term "connected with" was intended to designate a legal or merely a de facto connection, and whether the "matters pertaining" included the priority of the right of the assignee. He recalled that the Commission had sought, as a matter of policy, to frame a rule excluding receivables secured by a mortgage. He could accept the proposal if that was the intention it conveyed. However, it was not clear whether a different rule would apply to a mortgage governed by the ordinary law of the State in which the land was situated.

16. Mr. WHITELEY (United Kingdom) said that all the delegations involved in drafting the proposal had been aware of the need to deal with all the interests associated with land, which would include mortgages as well as sales and leases. A person with an interest in land as the result of a mortgage would be able to determine the priority of his interest in accordance with the local law. The rules of that law would override any other provisions of the Convention in the event of incompatibility. As for the expression "connected with an interest in land", it had intentionally been framed as broadly as possible, in order to ensure that the new article would apply to any interest in land. It would not be an acceptable outcome for leases on land to be treated differently from other interests in land, as suggested by the representative of the United States. If the Commission made a policy decision to that effect, the text of the proposal would have to be revised.

17. Mr. DOYLE (Observer for Ireland), supported by Ms. POSTELICESCU (Romania), said that the problem was a drafting matter that should be left to the Drafting Group. The intention had been to cover as many interests in land as possible, including leases, and the text did just that. He urged the Commission to adopt the wording as it stood.

18. Mr. SMITH (United States of America) observed that any priority rule adopted must not disrupt the patterns of real-estate finance which it was the Convention's purpose to facilitate. If, for example, a receivable was secured by an interest in land and consisted of a promissory note or other contractual right to payment secured by a real-estate mortgage, should the rule provide that competing assignees would look to the assignor's State as opposed to the State where the real estate was located? Many receivables were partly secured by an interest in land, and it was not unusual for commercial loans to be secured by both personal and real-estate property. Whether under national law a real-estate recording system would normally provide for an assignment of such real-estate-related receivables might well be the key to determining whether the priority of the receivable should be governed by the location of the real estate or that of the assignor. Priority was normally based on the requirements of the real-estate recording system under which the parties wanting priority were required to register. The language of the text was much broader and contrary to real-estate practices.

19. Mr. DESCHAMPS (Observer for Canada) said that under the Convention, in the case of an assignor who assigned a receivable secured by personal property and a piece of real estate, the law of the assignor would govern the priority of the rights of an assignee who had not registered against the land. If that assignor became bankrupt, the assignment should be effective against the trust-in-bankruptcy even if the assignment had not been registered against the land. Furthermore, if such a receivable was assigned to a second assignee, who had not registered against the land, the initial assignee should retain priority even without registration against the land. The initial assignee's priority would be defeated only if the subsequent assignee had registered against the land and the initial one had not.

20. Mr. BERNER (Observer for the Association of the Bar of the City of New York), supported the comments made by the United States and German representatives. The phrase "connected with" gave rise to problems. If, for example, admission fees for an amusement park or landing fees in an airport were assigned to a bank in another State, the assignment would be outside the scope of the Convention, even though it was connected to the land. Also, the conjunction "and" before the term "the priority of the right of the assignee" implied that priority issues did not pertain to an interest in land. In that regard, he endorsed the German representative's comments and said that the word "including" would be preferable. In the text under consideration, the Commission found itself in a grey area that went beyond mere drafting.

21. Mr. MORÁN BOVIO (Spain) observed that the admission receipts or airport fees just mentioned did indeed fall outside the article under consideration, though not outside the Convention altogether, because they constituted another form of credit. For the most part, the text was clear enough: where credit was mortgage-secured, the applicable law was the law that governed the land in question. The text needed to be kept as broad as possible.

22. Mr. DOYLE (Observer for Ireland) said that he had heard no one offer a better formulation than the expression "connected with", which was intentionally vague. The text indeed managed to cover as many interests connected with land as possible. The formulation was deliberately wide, even if that was unacceptable to certain financial interests, because otherwise the Convention would not be acceptable to States.

23. Mr. WHITELEY (United Kingdom), responding to the comments of the representative of the Association of the Bar of the City of New York, said that the proposed text did not completely exclude interests in land from the Convention but did apply the rules differently. The example the representative had

given, however, well represented the scope of the text: the Convention's sole effect on airport or admission fees, which were indeed receivables connected with an interest in land, was to provide that they would be governed by the law of the State where the airport or the amusement park was situated. The fees in question did not create an interest in land or make it necessary to vary the priority rules, because there was no claim against the assignee.

24. The United States position seemed to differ from that of the text in that it maintained that all matters, including priority interests in a receivable, would be governed by the same law as the law that governed the priority of the interest in the land. The United Kingdom position, which was that the only applicable law could be that of the jurisdiction where the land was situated, was therefore less broad.

25. Mr. CARSELLA (Observer for the Commercial Finance Association), concurring with the United States concerns that the text was too broad, said that what was at stake was the interest that each State would have in land that had its own unique set of regulations and in the use of such real estate as security. The broad approach taken by the text encompassed all receivables related to real estate without adequately specifying how they were to be covered. In the process, it included many different types of loosely connected receivables that had an impact on types of financing that the Convention was not intended to affect. A policy issue was involved. Thus far, most of the Commission seemed to be favouring the most inclusive possible text that would not differentiate between the actual receivable that was generated and the unique, specific rules and regulations that applied to the underlying real estate.

26. Mr. SMITH (United States of America), agreeing that it was a question of policy, said that originally the Commission's concern had been that real-estate financing and receivables secured by real estate might require a different choice-of-law priority rule. No one had originally contemplated the possibility that the choice-of-law rule in the Convention could be changed merely because a receivable was secured by an interest in real estate, regardless of the value of the real estate in relation to all other collateral or the value of the receivable itself as an unsecured credit. That possibility exposed the choice-of-law rule to broad manipulation. It required that anyone lending against receivables should investigate whether any receivable was secured by an interest in land in order to determine what the proper choice-of-law priority rule was.

27. The United States delegation could not support such a broad undermining of the Convention priority law rule. It could, however, support either a specific rule or an exclusion that was much more narrowly focused on the original concern, which, as his delegation understood it, had to do with national real-estate law and the question whether under such law someone with an interest in the land acquired an interest in a receivable generated by that land. If so, it might be useful to have a specific Convention rule to accommodate real-estate financing in the State concerned. One must first consider the law of the State where the land was located: if the receivable was acquired by someone with an interest in the real estate with which it was connected, the exception would apply; but if someone received only the real estate itself and the receivable was separate, then the receivable—even though connected with the real estate—should be subject to normal priority rules under the Convention.

28. Ms. McMILLAN (United Kingdom) suggested that the United States delegation should put forward an alternative proposal.

29. Ms. WALSH (Observer for Canada) noted that the formulation that would satisfy the concerns of the United States delegation was close to the rule originally proposed on the question, namely, the need to qualify the operation of the priority rule in article 24 in cases of claims by someone who had acquired a right in real estate along with a right in a competing receivable. The aims of the draft article had later been expanded to ensure that all matters pertaining to any interest in land would be subject to the lex situs, an interpretation which appeared required. Her delegation suggested that the Commission should separate the issue of priority from the general aim of satisfying concerns as to the primacy of the lex situs in the case of land interests. By combining two different objectives, the Commission might have inadvertently distorted the original attempt to qualify article 24.

30. Mr. BURMAN (United States of America) observed that a desire to improve the Convention had gone too far. The purpose of the Convention should be to mobilize commercial funding for the developing world. Because in developing States the value of land was very limited, the considerable value of receivables needed to be harnessed to promote further commercial and economic development. If the Commission was not careful, the Convention would, under the guise of protecting what had begun as a limited range of realty rights, cut off a source of additional commercial credit from the very countries that most needed it.

31. The CHAIRMAN suggested that the developing nations, which were well represented in the Commission, would have given their views if they had felt that their interests were in jeopardy.

32. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the observer for Canada had drawn attention to the problem that had been created by bringing together two proposals that differed in intent and scope. The Commission was required to decide whether exclusion was the proper approach; and whether a broad applicable-law rule referring to all matters related to an interest in land and connected in any way with a receivable would be appropriate, rather than a limited priority rule dealing with the conflict between the interest of an assignee under the Convention and the interest of a holder of land who, under the law of the land, would have an interest also in the receivable and would be in conflict with the assignee under the Convention.

33. It should be noted that the concerns about the statutory prohibition of receivable assignments, including real-estate receivables, would be covered by article 9 and that therefore those concerns had probably already been addressed by the earlier clarification of statutory limitations.

The meeting was suspended at 4.35 p.m. and resumed at 5.05 p.m.

34. Mr. MORÁN BOVIO (Spain) said that, although his delegation had initially supported the joint proposal submitted by Canada and the United Kingdom (A/CN.9/XXXIII/CRP.6), the comments made by other delegations had raised doubts about its merits. The proposal seemed too broad. Instead of referring only to a receivable connected with an interest in land, it might be more appropriate to refer to a receivable connected with an interest in land and directly enforceable with respect to such land. Another solution might be to include in article 24 a special rule dealing with cases of receivables connected with an interest in land.

35. The CHAIRMAN suggested that the words "Where a receivable is connected with an interest in land," could be replaced by "Where a receivable arises from an interest which is enforceable against land," in the joint proposal of Canada and the United Kingdom. It had been suggested that the word "and" should be replaced by "including"; the second part of the proposal would then read: "the law of the State in which the land is situated governs all matters pertaining to that interest, including the priority of the right of the assignee with respect to the competing right of a person who holds an interest in the land".

36. Mr. DOYLE (Observer for Ireland) said that, although his delegation was aware of the objections that had been raised, including those of the United States delegation, it continued to support the joint proposal of Canada and the United Kingdom. It could also accept the wording suggested by the Chairman. If delegations wished to make proposals that were substantially different from the proposal under consideration, they should do so in writing.

37. Mr. STOUFFLET (France) said that, assuming that the Convention contained no reference to receivables in connection with an interest in land, if a receivable guaranteed by a mortgage was assigned under the terms of the Convention, the mortgage would be transferred in accordance with the provisions of the law of the State in which the real estate was situated. In certain legal systems, including the French legal system, certain assignments of long overdue rents were effective only if they were published in the land register. In such case, the same problem arose: an assignment that by its nature arose from the Convention would be subject both to the provisions of the Convention and the law of the State in which the assignment was made. The proposal by Canada and the United Kingdom was an application of that very simple principle of international law. Since the spirit of that proposal was in line with the general principles of private international law, his delegation believed that the proposal was entirely acceptable.

38. Mr. SMITH (United States of America) said that his delegation believed that the very narrow problem that the Commission was debating was the situation where, under the law of the State in which the land was located, a person who had an interest in the land obtained, because of that interest, an interest in the receivable that had been assigned. That situation was an example of the typical conflict between real-estate law and the law of personal property, and it was the only narrow priority conflict that his delegation believed was being discussed. There were two ways to deal with that conflict: the priority conflict could be excluded from the choice-of-law priority rule, or priority could be given to the real estate claimant if, under the law of the State in which the real estate was located, the real estate claimant would have priority. The issue before the Commission concerned only a competing interest in the receivable and not a competing interest in the land.

39. Mr. WHITELEY (United Kingdom) said that the use of the word "including" instead of "and" in the second line of the proposal by Canada and the United Kingdom had been considered and rejected because the second part of the proposal related to receivables and not to interests in land. The second part of the proposal determined priority rights in the receivable in so far as there was a conflict between the owner of the receivable (perhaps the assignee) and the owner of an interest in land where the two overlapped.

40. It had also been suggested that the first part of the proposal was too broad. His delegation had intended that that part of the proposal should be quite narrow and to focus on the specific issue of interests in land and their determination in accordance with the lex situs. To that end, his delegation had incorporated in the proposal language at the beginning that did have broad effect.

41. In so far as the first part of the proposal had any effect on interests in land and the rules of the Convention, it meant that the law of the place where the land was located would govern interests in land, while all other issues, including issues in relation to any receivable, would be governed by other applicable law, which might include the provisions of the Convention. If the first part of the proposal was reformulated, it would be necessary to cover not only matters such as sales, proceeds from land and leases of land but also mortgages and the effect of the assignment of a receivable on the mortgage interest where the two were connected. For that reason, his delegation suggested that any reformulation should include the words "or where the assignment of the receivable would create or transfer an interest in land".

42. Mr. IKEDA (Japan) said that his delegation fully agreed with the observations made by the representative of France. The scope of the provisions relating to exclusion should be limited as much as possible.

43. Mr. MORÁN BOVIO (Spain) said that the United States delegation should read out its proposal, since that might help the Commission get around the difficulties raised by the proposal of Canada and the United Kingdom.

44. Mr. BERNER (Observer for the Association of the Bar of the City of New York) said that the examples he had given were not speculative. In the past decade, a United States court had ruled that the examples he had cited represented an interest in land. The Commission had to be very careful since such issues were not purely drafting issues.

45. Mr. DOYLE (Observer for Ireland) said that his delegation could accept a limitation on the language of the proposal by Canada and the United Kingdom, as suggested by certain delegations, including Japan. The United States delegation should read out its proposal, if it had one.

46. Mr. SMITH (United States of America) said that his delegation proposed the following alternative wording:

> "If a receivable is associated with land, such that, under the law of the State in which the land is situated, a person with an interest in the land has rights in that receivable, then the rights of the assignee with respect to the receivable are subordinate to the rights of any person to whom, under the law of the State in which the land is situated, the assignee's rights would be subordinate."

47. The CHAIRMAN asked the United States delegation to explain the policy differences between its proposal and the proposal that had been submitted by Canada and the United Kingdom (A/CN.9/XXXIII/CRP.6), bearing in mind that concerns about regulatory regimes on ownership or assignment of land appeared to have been dealt with during the discussion on articles 9 and 10 of the draft Convention.

48. Mr. SMITH (United States of America) said that the intent of his delegation's proposal was to narrow the application of the rule and, if the rule applied, to defer to the law of the State in which the real estate was located for certain priority purposes.

Two conditions would have to be met in order for the rule to apply: the receivable would have to be associated with land; and, under the law of the State in which the land was situated, a person with an interest in the land would have to have acquired an interest in the receivable in consequence.

49. The effect would be that, if, under the law of the State in which the land was situated, someone else had priority over the assignee, that person would be entitled to that priority. If there was no such person, the normal rule of the draft Convention would apply.

50. Mr. WHITELEY (United Kingdom) said that the United States proposal might not completely cover situations where receivables were assigned and the assignor had the benefit of a security interest in land, particularly if, under local law, the security interest did not automatically follow assignment of the receivable. Moreover, it did not address certain public policy concerns regarding interests in land that did not relate to limitations on assignments. One such issue involved public policy with regard to eviction notices to protected tenants.

51. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said he assumed that the United States proposal was not concerned with a conflict between an assignee with a security interest in land connected with a receivable and a holder of an interest in land not related to the receivable, since such a conflict would be settled by local law in any case. With regard to public policy, the concerns expressed by the United Kingdom and other delegations might be answered by article 25, which would have the effect of setting aside the rule of the law of the assignor's location in cases where the provision was manifestly contrary to the public policy of the forum State, which in the current instance was the State where the land was located.

52. Mr. MORÁN BOVIO (Spain) said that the United States proposal had the advantage of addressing a narrowly defined problem concerned with competing claims, while leaving all other issues to the general rules of the draft Convention. It preserved much of the scope of application of the rule of the law of the assignor's location. In its narrow focus, it appeared to be very much like Canada's original proposal.

53. Ms. LADOVÁ (Observer for the Czech Republic) said that her delegation supported the views expressed by the United Kingdom.

54. Mr. TELL (France) said that the United States proposal appeared to be somewhat narrower than was warranted, since local real-estate law might apply in situations other than the one defined in the proposal. An alternative wording might read: "No provision of this Convention affects the application of the law of the place where the real estate is located when the assignment relates to rights connected with that real estate."

55. Mr. SMITH (United States of America) said that the approach suggested by the French delegation could be explored. Some of the questions that had been raised in the course of the discussion had been addressed in article 12 and, if necessary, might be resolved through amendments to it. The question had been raised whether a mortgage did or did not follow the assignment of the receivable secured by the mortgage. Article 12 (1) provided that if the security did not automatically follow the receivable under the law governing the security, the assignor was obliged to transfer the right to the assignee with a new act of transfer. Another issue raised was that, under some national laws, foreign assignees might not be permitted to have an interest in real estate. If it was desirable for the draft Convention to defer to such laws, it should be easy to provide for such concession without creating a different priority rule.

56. Mr. CARSELLA (Observer for the Commercial Finance Association) said that, since it could be assumed that questions regarding an interest in real estate would be adjudicated by the jurisdiction in which the real estate was located, the real issue facing the Commission was how to deal with competing interests in a receivable in some way related to that real estate. His Association thought that articles 9 and 25, perhaps with some modification, could address the possibility that the law of the forum State, in such cases the lex situs of the real estate, had a public policy protecting certain interests in real estate. A situation his Association often encountered was that local real-estate law might give a landlord an automatic lien on goods stored on leased premises, a lien that would compete with a consensual lien on the goods held by a financing entity. Article 25 appeared to allow for those interests to prevail as a matter of public policy.

57. Mr. DOYLE (Observer for Ireland) said that he had come to the session with clear instructions that industry in Ireland was not happy with the application of the draft Convention to real estate, and he had therefore supported the original proposal for exclusion. Since there was little support in the Commission for exclusion, however, as a compromise he was willing to support the joint proposal of Canada and the United Kingdom (A/CN.9/XXXIII/CRP.6) applying the lex situs of the real estate to all matters pertaining to interests in land. The articles of the draft Convention that dealt with public policy issues did not meet his delegation's concerns.

58. Mr. DESCHAMPS (Observer for Canada) said that a compromise solution might be to deal with the question of statutory limitations on assignments related to interests in land in a separate section and to deal with the priority issue through a provision similar to that suggested by the United States delegation, but with one modification. The United Kingdom delegation had pointed out that the latest United States proposal addressed the issue of lease payments but not of receivables secured by mortgages. His delegation's suggestion was to replace the "if" clause or "trigger" clause in the United States proposal with the following words: "Where a receivable is secured by land or arises from a lease of land, ...". The remainder, from "then the rights of the assignee ...", would remain the same.

59. Mr. SMITH (United States of America), in answer to a question from the Chairman, said that there was, in fact, a policy difference between the two proposals. The thrust of his delegation's proposal was that a person who had an interest in land would have to acquire an interest in the receivable in consequence in order for the provision to apply. The Canadian proposal just made was broader. However, if the effect of the Canadian wording would be to ensure that someone with an interest in the real estate under local real-estate law was not hurt by the application of the Convention, his delegation could work with it.

60. The CHAIRMAN suggested that the delegations should consult in order to reach a solution.

The meeting rose at 6 p.m.

Summary record of the 690th Meeting

Wednesday, 21 June 2000, at 10 a.m.

[A/CN.9/SR.690]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.10 a.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.6 and 7)

1. The CHAIRMAN invited the Commission to continue its consideration of possible exclusions from the draft Convention of assignments of receivables relating to an interest in land.

2. Ms. GAVRILESCU (Romania) said that, as submitted by the Working Group on International Contract Practices, the draft Convention was to have been general in scope, but provision had been made—in article 4(2) and article 39—for States to enter reservations concerning specific practices. Her delegation had found that approach fully acceptable. During the Commission's consideration of the draft, however, the United States delegation had submitted a long and thoughtful list of exclusions, many of which her delegation had been able to support. At that point, the focus had changed: the Commission had adopted a new policy of compiling a complete list of exclusions, which would obviate the need for article 4(2) and article 39. The United States delegation had then suggested excluding real estate transactions from the scope of the draft Convention; again her delegation had felt able to support that concept. That had been followed by proposals from the delegations of Canada and the United Kingdom, the former of which had established a useful link between real estate and the State where such real estate was located. The only drawback to the two proposals was that the first had been presented in the context of article 24 and the second in the context of article 25, thus limiting their scope.

3. Her delegation could accept a new formulation which took account of the objections raised by the United States and Germany, or the adoption of the first part of the Canadian proposal, or a simple provision that any transaction should be governed by the law of the State in which the real estate was located, or the proposal submitted by the representative of France the previous day. Her delegation did not believe that it would be detrimental to the draft Convention to include special rules governing specific practices, but, if that ran contrary to the general view, her delegation would bow to the will of the majority. The options, then, were either to compile a complete list of exclusions, including real estate, under article 24 or to retain article 4(2) and article 39. In the latter case, the draft Convention would apply to real estate as to other areas. That would be welcomed by some delegations, including that of the United States, whereas others would be free to enter reservations.

4. The CHAIRMAN commended the flexibility shown by the Romanian delegation. He recalled, however, that it had been agreed to defer a final decision on article 4(2) to which many delegations were opposed, until the scope of the draft Convention had been determined.

5. Mr. SMITH (United States of America) proposed the following text for an exclusion relating to real estate.

6. In the case of a receivable secured by or arising from the sale or lease of an interest in real estate, nothing in this Convention *(a)* affects the rights of a person entitled to priority in the receivable pursuant to the real estate law of the State in which the real estate is located or *(b)* authorizes an interest in the real estate that is not permitted under that law.

7. The aim of the proposal, which built on that submitted by the French delegation the previous day, was to underline two points of policy: first, if a person was, under real estate law, entitled to priority in connection with a receivable, the draft Convention would not affect that priority. Secondly, the draft Convention had no effect on national law concerning persons entitled to hold an interest in real estate. Where a receivable was secured by an interest in real estate, the mortgage on that property would serve as the security.

8. Mr. MORÁN BOVIO (Spain) welcomed both the flexibility displayed by the Romanian delegation and the United States proposal, which constituted a marked improvement on previous proposals. The Commission should adopt it without further ado.

9. Mr. TELL (France) said that his first reaction was uncertainty as to what precisely clause *(a)* aimed to exclude: he did not understand whether it was the receivable or the real estate that was affected by the priority. Moreover, France had no exact equivalent for "real estate law", which indeed differed in every country. Lastly, it seemed that the word "interest" would have different meanings in the chapeau and in clause *(b)*.

10. Mr. MARADIAGA (Honduras) said that the previous speaker had pinpointed a real difficulty. The right to or interest in a receivable clearly did not involve an actual title to the real estate concerned, but that position should be stated more clearly. Subject to the necessary revision, his delegation would support the proposal.

11. Mr. AL-NASSER (Observer for Saudi Arabia) said that the United States position, as reflected in the proposal, was similar to that of Romania—namely that all receivables issuing from a real estate transaction were subject to the law of the State in which the real estate was located—except in respect of clause *(b)*, from which it was unclear whether the interest that was authorized was subject to the law of the State in which the real estate was located. If it was, there was no need for clause *(b)*, because the proposal contained nothing new. If, however, the proposal related to legislative decisions or to entitlement, further clarification was required from the United States delegation.

12. Mr. DOYLE (Observer for Ireland) said that the United States proposal largely met his delegation's concerns. With regard to the perceived ambiguities, he said that the word "interest" had a well-established meaning in Irish law, while "real estate law" was the equivalent of "land law" or the "law of real prop-

erty". The Commission should decide whether it accepted the principle behind the proposal and leave the detailed wording to the drafting group.

13. Mr. SCHNEIDER (Germany) expressed general satisfaction with the proposal. He suggested, however, two changes that might solve some outstanding difficulties and at the same time broaden the scope of the provision. First, he suggested that in clause *(a)* the words "real estate" should be deleted; it was sufficient to refer simply to the law of the State. Secondly, in clause *(b)*, the phrase "that is not permitted under that law" should be replaced by the phrase "that interferes with that law." He also drew attention to a problem to which his delegation would revert during the consideration of article 19, paragraph 5. The law concerning priority was exceptionally complex; he himself had found it difficult to understand the subtleties involved. Yet every time that a debtor needed to find out whom he was to pay he would be forced to grapple with those complexities. The task for the assignee was much simpler.

14. The CHAIRMAN said that it was essential that the text should be comprehensible to those affected by it.

15. Ms. LADOVÁ (Observer for the Czech Republic) said that her delegation found the proposal acceptable, especially with the change suggested by the representative of Germany. For the time being, the words "real estate" could be placed between square brackets. With regard to clause *(b)*, she favoured the insertion of the phrase "the acquisition of" before the words "an interest".

16. Mr. SMITH (United States of America) said that the aim of the proposal had been to establish the principle that the claims of people who had priority because of a claim on the real estate itself would not be interfered with. He was opposed to deleting the words "real estate" in clause *(a)* because that would provide an opening for a creditor to make a claim even if he had no interest in the real estate and might undermine article 24. He suggested that the phrase "law governing real estate" might be used. He stressed that the proposal did not concern conveyances of interest in real property but simply interest in the receivables, which were clearly subject to prior claims on the real estate itself and would have to comply with the law in the State in which the real estate was located.

17. Mr. TELL (France) said that he did not fully understand the intent of the United States proposal or to what legal situations it would apply. The proposal appeared to indicate that the draft Convention was without prejudice to the rules governing real estate, yet that point seemed obvious. He did not understand how the draft Convention could interfere with the rules concerning the determination of priority in cases where there were competing creditors. He asked what type of interest in real estate was envisaged in the proposal. Perhaps clause *(a)* was unnecessary.

18. Ms. GAVRILESCU (Romania) said that she associated herself with the comments made by the representative of France. Since the proposal was based on ideas put forward by the French delegation the preceding day, it should reflect the original wording of those ideas. She asked whether the proposal implied a connection between real estate and the law of the State in which the real estate was located; if so, the United States delegation should clarify that connection.

19. Mr. DESCHAMPS (Observer for Canada) said that the most common situation that would be covered by the proposal was probably one in which an assignor assigned a receivable secured by a mortgage on real estate, and the law of the State in which the real estate was located provided that priority between two assignees, in the case of assignments of receivables secured by real estate, should be given to the assignee who had first registered the assignment. If neither assignee had registered the assignment, the provision proposed by the United States would not apply, since real estate law would not come into play and the priority would be determined by the law of the assignor's State. The aim of the proposal was to ensure that, in case of a conflict between the law of the assignor's State and the law of the State in which the real estate was located, the latter would prevail. In clause *(a)* of the United States proposal, the reference to real estate law should be retained, because an indication that priority should always be determined by the law of the State in which the real estate was located would completely disregard the law of the State of the assignor, whereas the law of the latter State determined priority except in the specific cases covered by the proposed provision. In clause *(b)* of the proposal, the phrase "authorizes an interest" should be changed to "authorizes the acquisition of an interest".

20. Mr. MORÁN BOVIO (Spain) said that he was satisfied with the United States delegation's explanation as to why clause *(a)* of its proposal should refer specifically to the real estate law of the State in which the real estate was located, since a reference to the "law" of that State in general could indeed make it possible for any creditor to claim priority and would depart completely from the rules for the determination of priority laid down in article 24, which was one of the pillars of the draft Convention. Under those rules, priority was determined according to the law of the State in which the assignor was located. Clause *(a)* of the United States proposal was intended not to change those rules, but to provide for a very specific exception; it was therefore necessary to keep that exception as narrow as possible by referring to "real estate law". However, clause *(b)* appeared to confirm an idea that was already clear from the text; namely, the general rule concerning the necessity of respecting national law. Clause *(b)* was therefore unnecessary.

21. Mr. DOYLE (Observer for Ireland) said he agreed that the reference to "real estate law" should be retained in clause *(a)* of the proposal and that the words "the acquisition of" should be inserted in clause *(b)*, as proposed by the Canadian delegation. Both points should be retained, as both were useful.

22. Mr. FRANKEN (Germany) said that the term "real estate law" in clause *(a)* was too narrow. For example, in many countries, priority in cases of insolvency in connection with a receivable secured by a mortgage was determined not by real estate law, but by insolvency law. If clause *(a)* was retained, the reference to the law of the State in which the real estate was located must be broadened. He agreed with the French delegation that clause *(a)* seemed unnecessary, since it repeated the considerations on priority contained elsewhere in the draft Convention. Clause *(b)*, if worded more broadly, would cover the points contained in clause *(a)* and would address the questions raised by the Canadian delegation. He proposed that the wording of clause *(b)* should be changed to read, "authorizes the acquisition of an interest in the real estate that interferes with the law of the State in which the real estate is located". That formulation would address the concerns of all delegations.

23. Ms. GAVRILESCU (Romania) said that if the Commission agreed that the provision contained in clause *(a)* of the United States proposal was necessary, she would join the consensus. With respect to clause *(b)*, she would prefer the change proposed by the Canadian delegation.

24. Ms. MANGKLATANAKUL (Thailand) said that she associated herself with the comments made by the German delegation with respect to real estate law. In Thailand, real estate law did not deal with questions of priority; those issues were covered under the civil and commercial code and insolvency law. Moreover, the United States proposal did not solve the problem of the competing rights of persons with an interest in land and persons with an interest in receivables connected with an interest in land.

25. Mr. SMITH (United States of America) said that the intention of his delegation's proposal was to establish a principle and that he was flexible with respect to the drafting of the proposed provision; for example, the drafting suggestions of the Canadian delegation were perfectly acceptable.

26. With respect to the question of whether clause *(a)* should refer to all the law of the State in which the real estate was located or only to the law governing the rights deriving from the real estate, it was necessary to consider, for example, the case in which an assignor of a receivable secured by an interest in real estate was located in a country whose priority rules differed from those of the country in which the real estate was located. If such an assignor assigned the receivable to more than one assignee, it was necessary to specify which country's law was recognized by the draft Convention as determining the priority to be accorded to those assignees. The draft Convention provided that, in general, the priority rules of the State in which the assignor was located should prevail. If clause *(a)* referred only to the law of the State in which the real estate was located, the priority rules of that State would apply even to cases in which no real estate-related creditor was claiming an interest in the real estate.

27. According to the original United States proposal, the draft Convention would look to the laws of the State in which the real estate was located only to protect persons having an interest in the real estate in that State and who, because of that interest, might also have an interest in the corresponding receivable. The problem in question was a very specific one. However, the law of the State in which the real estate was located should not be preferred merely because a receivable was associated with that real estate.

28. The proposed insertion, in clause *(b)*, of the words "interferes with" could create uncertainty for those who extended credit against receivables secured by an interest in real estate. The current formulation was narrower and dealt with national laws that determined who could hold an interest in real estate.

29. With respect to the question raised by the representative of Thailand as to whether the draft Convention adequately dealt with the situation in which a person claiming an interest in real estate also claimed an interest in a receivable secured by such real estate in competition with the assignee of the receivable, the principle on which clause *(a)* of his delegation's proposal was based was that the draft Convention would provide no rule in that situation. Instead, it specified that such conflicts were to be resolved not by the draft Convention, but by national laws.

The meeting was suspended at 11.30 a.m. and resumed at 12.05 p.m.

30. Mr. TELL (France) said he did not understand what was meant by the word "interference". It was not a legal term, was not likely to be found in any United Nations international conventions and was not appropriate for inclusion in clause *(a)*.

31. Mr. BURMAN (United States of America) said the consultations had indicated that the Commission was close to reaching a consensus. Many of the differences related to drafting rather than matters of policy. He recommended that the matter be referred to the drafting committee.

32. The CHAIRMAN suggested that the drafting committee would need some guidance, particularly as to whether the reference in clause *(a)* should be to the real estate law of the location of the land or to the entire law of that location.

33. Mr. SMITH (United States of America) said that there had never been any intention to refer to the entire law of the State where the real estate was located, but rather to those laws that would benefit someone holding an interest in the real estate, even if that interest did not arise under real estate law as such. If someone held an interest in the real estate, that person's right would be determined by all of the relevant protective legislation.

34. Mr. AKAM AKAM (Cameroon), referring to clause *(a)* of the American proposal, agreed that the Commission should give some guidance to the drafting committee. The first problem was the reference to real estate law. In his country, the priority issue was regulated not by real estate law but by specific texts that related to securities. Real estate law should therefore not be specifically mentioned in the draft text. It would have been logical to follow the law of the State of the assignor. If the Commission preferred the law of the State where the real estate was located, specific mention should be made of the national legislation dealing with issues of priority rather than to the law in general.

35. Mr. AL-NASSER (Observer for Saudi Arabia) said he preferred to include a reference to the law of the State in which the real estate was located, as otherwise there could be a conflict between the different national laws, including those dealing with property in general.

36. The CHAIRMAN said he took it that the Commission had reached a consensus on policy matters, and that it would now leave the wording to the drafting group.

37. Mr. DESCHAMPS (Observer for Canada) requested the drafting committee, when drafting clause *(a)*, to take into consideration the second part of the written proposal submitted on the previous day by the delegations of Canada and the United Kingdom in order to resolve the difficulty relating to the reference to real estate law.

38. The CHAIRMAN invited the Commission to consider the proposal made by the secretariat of the International Institute for the Unification of Private Law (UNIDROIT) contained in document A/CN.9/XXXIII/CRP.7.

39. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) pointed out that the word "incurred" in paragraph 2(x) should be changed to read "secured".

40. Mr. BURMAN (United States of America) said that the Commission had in the previous week heard presentations from UNIDROIT and also from representatives of the industries producing the three types of mobile equipment referred to in the definition proposed for inclusion in article 6—aircraft (including airframes, aircraft engines and helicopters), railway rolling stock and space property. His delegation had been persuaded that those markets were indeed well-established. They were clearly demarcated from general commercial finance, to the extent that aircraft

financing was distinct from general receivables financing. Some special treatment should be given to those industries, and the exclusion that they had requested seemed appropriate. The present draft Convention and the protocols and UNIDROIT draft Convention together might deal with priority when they came into force. If the present Convention was adopted without the adoption of the UNIDROIT draft Convention (which was not yet completed) there would be disruption in those important markets. An exclusion under article 4 therefore seemed an appropriate solution.

41. His delegation had some concern about the breadth of the language, but it seemed to accurately reflect the types of transactions that should be excluded. There were sales of mobile equipment that were financed by the seller, who retained the title until the price (the receivable) had been paid. In other cases, a third party financed the acquisition and was granted a security interest in the mobile equipment to secure payment of the purchase price. A third category related to rental payments that were considered as associated with the mobile equipment. A fourth category consisted of loans made to the owner of mobile equipment where the loan was secured primarily by that equipment. Any exclusion should be limited so that it could not be manipulated, for example by a general financier including an aircraft in the general financing of the operations of a borrower. The language presented seemed sufficient, but should be considered by the drafting committee.

42. Mr. TELL (France) said that there was no reason to limit the scope of application of the draft Convention by excluding transactions involving certain types of equipment. The UNIDROIT draft Convention on international interests in mobile equipment had not yet been adopted, nor had certain problems relating to that instrument's approach to assignments been resolved. He agreed with the representative of the United States of America that any exclusions should be as limited as possible; it was important to avoid creating gaps in the legal regime.

43. The criteria for applicability under the draft Convention were perfectly clear; those of the UNIDROIT draft Convention were less so. Article 3 (1) of the latter instrument stated that the Convention applied when the debtor was situated in a Contracting State, but there were also other application criteria which depended on the nature of the goods concerned. The exclusion proposed by UNIDROIT would, of course, have the advantage of resolving questions of applicability in States not parties to the UNCITRAL Convention.

44. Furthermore, there had been no intergovernmental consultations on the terms "railway rolling stock" and "space property", and there was no legal definition of the latter term. The interests to which the United States representative had referred were those expressed by private groups and would not necessarily be endorsed by Governments in their discussion of the relevant draft protocols to the UNIDROIT instrument.

45. The clause in the UNIDROIT proposal referring to "assignments of receivables arising from transactions" was unclear, since assignments were in themselves transactions. The proposed text also mentioned "primary" real security but did not explain on what basis such primacy was to be established. Above all, the UNIDROIT draft Convention referred to the assignment of interests rather than of receivables and, in a mechanism contrary to most national legal systems, to the assignment of the right to payment; that fact could lead to problems where the two transactions involved different assignees.

46. The proposed amendment to article 6 was also problematic because, since the UNIDROIT draft Convention had not yet been adopted, the terms mentioned had no legal definition and judges of different countries might well disagree as to their meaning.

47. The CHAIRMAN noted that the current UNIDROIT proposal had been preceded by a proposal for a deference provision. The Commission needed to decide how to interface the two draft conventions.

48. Mr. ATWOOD (Australia) said that his delegation preferred the exclusion approach and was prepared to accept the UNIDROIT proposal subject to the drafting change read out by the Secretary of the Working Group and to the solving of the problem raised by the French delegation concerning the term "space property".

49. Ms. SABO (Observer for Canada) said that while her Government strongly supported the UNIDROIT draft Convention, she was opposed to the proposed amendment. Unlike the United States delegation, she did not think that special treatment should be accorded to the industries mentioned therein, and she agreed with the representative of France that the scope of the UNCITRAL draft Convention should be as broad as possible.

50. It had been argued that those industries had their own sophisticated, long-standing procedures which should not be disturbed and that the UNCITRAL draft Convention should defer to the UNIDROIT instrument in order to avoid potential conflicts. However, the proposed amendment would exclude all mobile equipment as defined therein, whether or not the State in question was a party to the UNIDROIT instrument; such a drastic approach was unnecessary. In any case, it was becoming increasingly unlikely that the Commission would complete its work on the draft Convention during its current session, in which case the matter could be settled once the UNIDROIT instrument had been finalized and adopted.

51. Lastly, if the Commission decided to provide for potential conflicts with the UNIDROIT draft Convention, it should do so under article 36 rather than article 4.

52. Mr. BERNER (Observer for the Association of the Bar of the City of New York) said that he considered the proposed exclusion an appropriate means of avoiding disruption in the way in which mobile equipment was financed. However, the term "primary real security" was unclear; the intent appeared to be to prevent transactions from being deliberately excluded from the scope of the draft Convention through the incorporation of a single piece of mobile equipment. Perhaps the word "real" should be deleted. Another problem lay in the meaning of the term "space property", which could cause problems if, for example, it was interpreted as including equipment located on the ground but used, inter alia, to track orbiting satellites. The problem might be referred to the drafting committee.

53. Mr. HERRMANN (Secretary of the Commission) said that since the main purpose of the proposal was to exclude special markets, it would be helpful for the Commission to receive information from delegations familiar with the industries in question. The Drafting Group could not be asked to settle substantive issues such as the potential for conflict with the UNIDROIT draft Convention.

The meeting rose at 1 p.m.

Summary record of the 691st Meeting

Wednesday, 21 June 2000, at 3 p.m.

[A/CN.9/SR.691]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 3.05 p.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.4 and 6-8)

1. The CHAIRMAN invited the Commission to resume its discussion of the proposal by the secretariat of the International Institute for the Unification of Private Law (UNIDROIT) for an exclusion of mobile equipment under article 4 of the UNCITRAL draft Convention (A/CN.9/XXXIII/CRP.7).

2. Mr. FERRARI (Italy) said that he fully supported what had been said by the representative of France at the morning meeting. It appeared that many issues remained to be resolved in the UNIDROIT draft Convention on International Interests in Mobile Equipment. With regard to space property in particular, work was not far advanced; the space working group had not even produced a definition of space property. As the observer for Canada had persuasively noted, once excluded the category would always be excluded, whether or not the UNIDROIT draft Convention ever went into force. Although the United States representative had cautioned against disrupting established industry practice, the observer for the Association of the Bar of the City of New York had pointed out that the market in space property, at least, was far from being stabilized.

3. On the basis of those considerations, his delegation had concluded that it did not favour exclusion and felt that the present wording of article 36 on conflicts with other international agreements sufficiently addressed possible conflicts with the UNIDROIT draft Convention.

4. Mr. RENGER (Germany) said that his Government, like many others represented on the Commission, was involved in the negotiation of the UNIDROIT draft Convention and had given instructions to his delegation to avoid any new conflict of conventions. However, as the representative of France had pointed out, many issues in the UNIDROIT text were still unresolved. Even with regard to aircraft, an area in which more progress had been made than with space property, UNIDROIT was still debating whether its draft Convention should apply only to larger aircraft. Since UNIDROIT would be holding more meetings in September and since the Commission was unlikely to finish its work during the current session, one option would be to defer a decision. But if a decision had to be made immediately, his delegation would opt for an article 36 approach rather than an exclusion. From the start it had been the policy of the Commission to make the draft Convention as broadly applicable as possible. Any exclusion would be permanent, unless the Convention was later amended, and the UNIDROIT draft Convention might never come into force, leaving large categories of assignments uncovered.

5. Ms. McMILLAN (United Kingdom) said that her delegation supported an exclusion approach and aligned itself with the position expressed by the representative of Australia at the morning meeting.

6. Ms. STRAGANZ (Austria) said that her delegation thought that, for the reasons expressed by France, Canada, Italy and Germany, it would be better to deal with the issue under article 36.

7. Mr. DOYLE (Observer for Ireland) said that, although his delegation had at first favoured an exclusion approach, it had been convinced by the arguments of France and Italy that it would be better to take a deference approach under article 36.

8. Mr. BURMAN (United States of America) said that, in view of the divergence of viewpoints, it might be as well to wait for more information before deciding what approach to take, particularly since it was apparent that the Commission would not be able to complete its work on the draft Convention during the current session. At the next session, technical representatives of the industries involved could be present to assist the Commission in reaching a more informed decision.

9. His delegation had not, however, changed its position that an approach based on article 36 would be inadequate to deal with the concerns expressed by the aircraft and railway industries about the application of the draft Convention to their established financing practices. Those concerns would remain whether or not the UNIDROIT draft Convention went into force. The two industries engaged in a highly specialized form of asset-based financing, an area of secured financing that differed in some respects from ordinary receivables financing. In aircraft financing, for instance, at some stages receivables and aircraft could not be separated. At other stages, more normal receivables financing might be possible, but the fact remained that the UNCITRAL draft Convention did not directly address the issues of most importance to the aircraft industry: priority and insolvency. The Commission had chosen to devise conflict rules rather than substantive rules on those issues.

10. There were some avenues the Commission might explore at its next session. One option might be to devise a conflict rule based on the law of the State of registration in the case of aircraft, although it was not clear whether such a rule would work for railway rolling stock. Another option might be to carefully tailor the language of the exclusion so that it related only to receivables inextricably attached to the aircraft. A distinction could be drawn between aircraft of, say, eight or more seats and smaller aircraft, a category commonly referred to as “general aviation”.

11. With regard to space property, it was clear that more information was needed. He would just point out that, quite apart from the question of the UNIDROIT draft Convention, there were other texts already in force on space law.

12. Delegations had generally been willing to accommodate the special needs of the banking industry. Like banking, the aircraft, railway rolling stock and space property industries were highly

specialized. Although less widespread than banking, the aircraft industry, for example, was of major importance to at least eight of the countries represented on the Commission. It would not serve the aims of the draft Convention to try to bring industries into it against their will, and it might make ratification that much harder.

13. Mr. FERRARI (Italy) said he agreed that the Commission needed more information but still felt that article 36 could provide an acceptable solution. Under the terms of that article, the more specific provisions of the UNIDROIT draft Convention would prevail, but anything left out, such as small aircraft, would fall under the UNCITRAL draft Convention.

14. Mr. TELL (France) said that the aircraft industry practice of inextricably linking a security interest to the aircraft asset was not something that warranted exclusion. The real problem was one of a possible priority conflict between an assignee of a security interest and an assignee of a receivable from the operation of the aircraft, since under the UNIDROIT draft Convention right to payment followed the security, in other words, the holder of a security interest in the aircraft automatically acquired the rights to the operating revenues. It should be noted that the problem had not yet been resolved by UNIDROIT; the articles in chapter IX of its draft Convention, those dealing with assignment, were not yet in final form.

15. Since, in all likelihood, the UNIDROIT draft Convention would be ready first, the Commission would then be at leisure to decide on the best mechanism for resolving a potential conflict between assignees under two different assignment systems. He did not think an exclusion was warranted. The matter could be dealt with either through a traditional conflict rule such as that in article 36, slightly amended to make the connection clear, or through a substantive rule. One should not dramatize the economic consequences. It was purely a matter of finding the right legal formula.

16. Mr. DOYLE (Observer for Ireland) agreed that the Commission should defer debate on the issue.

17. Mr. PALMIERI (Observer for the Commercial Finance Association (CFA)) said that it was his Association's position that the aircraft industry should not be excluded from the draft Convention. After attentive analysis, CFA had not discovered any area in which the aircraft finance industry would be disadvantaged by the draft Convention. Some delegations had mentioned the importance of the aircraft industry to certain States as a reason for exclusion. But the Canadian delegation opposed exclusion, even though Canada was home to one of the world's largest aircraft engine manufacturers. Ultimately, the issue to be resolved was not what was good for the aircraft manufacturing industry but how to facilitate and lower the cost of financing.

18. Some representatives had also mentioned the very long-term nature of aircraft financing as a reason for special treatment. CFA had gathered information on recent securitizations of aircraft and found that the length of time an asset remained in the pool ranged from two to eight years. Its research had uncovered no economic rationale for exclusion.

19. Mr. BURMAN (United States of America) said that many delegations had certainly been consulting with the aircraft industry, but, given the multinational nature of most of the companies, those discussions were by no means parochial.

20. The CHAIRMAN said that, the wide divergence of views, demonstrated that the issue had not matured sufficiently for the Commission to take a decision. He suggested that the Commission should resume consideration of the list of exclusions originally proposed in document A/CN.9/XXXIII/CRP.4; the drafting group was still interested in any further proposed amendments.

21. Mr. DUCAROIR (Observer for the European Banking Federation (EBF)) said that the exclusion concerning interbank payment systems, originally proposed in paragraph (ii)(D) of document A/CN.9/XXXIII/CRP.4, in its most recent version referred to assignments of receivables arising under interbank payments systems or investment securities settlement systems. The Federation would like to propose the insertion of the words "and interbank payments agreements" after "interbank payments systems".

22. Interbank payments might be made bilaterally, as between correspondent banks, or through a clearing system involving an indefinite number of participants, in which each bank had a debit or credit position with the system rather than with any other participant. Insertion of the new language would ensure that both methods were covered by the exclusion. It would avoid any need for a definition of "interbank payments systems", which, in the European Union at least, was interpreted as comprising at least three participants, thereby excluding bilateral agreements.

23. Mr. COHEN (United States of America) and Ms. WALSH (Observer for Canada) supported the proposal by the observer for the European Banking Federation.

24. Mr. SCHNEIDER (Germany) said that since there was no agreed definition of interbank payments systems, it was better not to attempt one. It was now being proposed that the excluded transactions should include bilateral agreements. However, during the preparatory work on the Model Law on International Credit Transfers the Commission had upheld the right of correspondent banks to be reimbursed for credit transfers by the persons who had placed the order for the transfer. No sound reason had been given for excluding that right, which was also a receivable. In his view, the proposal signalled a change of policy.

25. Mr. MORÁN BOVIO (Spain) did not believe that the proposed amendment would alter the Commission's policy; it was merely a welcome clarification, which would not have been necessary if the draft articles had included a definition of interbank payments systems. It had previously been pointed out that those systems posed a problem because they were sometimes bilateral and sometimes multilateral. However, it was necessary to distinguish between the arrangements for payment, which were normally made between several parties, and the actual payments, which took place between only two parties.

26. Mr. TELL (France) favoured a solution along the lines proposed by the observer for the European Banking Federation, because in the European Union an interbank payments system was an agreement involving at least three parties. It was important not to disrupt existing banking practices and priority rules by imposing other rules which were not part of the law governing the payments system in question. However, like the representative of Germany, he wondered why bilateral agreements giving rise to a reciprocal right to compensation were to be excluded from the Convention machinery. Moreover, it seemed that the exclusion would affect only banks, not other suppliers of credit such as businesses. The problem was already, perhaps, covered by the provisions of draft article 20.

27. Mr. DUCAROIR (Observer for the European Banking Federation) explained, in reply to the comments by the representatives of Germany and France, that his proposal was intended to respond to the Commission's present stance. The text originally proposed by the European Banking Federation attempted to cover the situation contemplated under the European regulations, which stipulated at least three member banks in an interbank payments system. In the United States, by contrast, such a system might comprise only two banks. It was his intention to avoid different interpretations of the term from one country to another, but without including a definition in the text. However, the term "interbank payments agreements" was not intended to cover all situations in which one bank was a creditor of another.

28. Mr. COHEN (United States of America) welcomed the EBF proposal. Rejecting it would in fact represent a change of policy, since his delegation in submitting its original proposal had made clear that an interbank payments system was intended to apply to arrangements between two banks as well as between three or more banks. However, the language of the original proposal had drawn upon the European regulations in such a way that it appeared to be confined to agreements between three or more banks. The new wording would help to avoid confusion. He advised against a change of policy. If the exclusion was confined to arrangements between three or more banks, draft article 20 would not resolve the problems which would arise in a system of payments between two banks. Moreover, the Convention would then interfere with the smooth functioning of such systems.

29. Mr. TELL (France) requested that, for the sake of legal certainty, a definition of the interbank systems concerned should be included in the text.

30. The CHAIRMAN recalled that the Commission had already decided not to include a definition. He noted that there was general support for the EBF proposal and for a broad exclusion rather than a narrow one. The issue should now be referred to the Drafting Group.

31. He invited the Commission to consider document A/CN.9/XXXIII/CRP.8, which contained a United States proposal concerning the application of draft articles 11 and 12.

32. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices), commenting on draft article 11, explained that it also covered agreements limiting subsequent assignments of a receivable. Paragraph (2) of the draft article made clear that the liability of a debtor under non-Convention law for breach of an agreement not to assign a receivable would not be affected; a debtor could be sued under national law for breach of contract, or other remedies could be sought. The assignee would not be liable, even if it had prior knowledge of the agreement; but tortious liability on the part of the assignee under non-Convention law would not be affected.

33. Mr. COHEN (United States of America) explained that the proposal had emerged, following consultations, from the Commission's previous decision to delete both draft article 5, on limitations of receivables other than trade receivables, and also the definition of trade receivables in draft article 6 (1). Draft articles 11 and 12 were intended to apply only to trade receivables, not to financial receivables. The proposal would therefore add an identical paragraph to both articles 11 and 12 stating that they applied only to certain categories of receivables, namely, those agreed for inclusion in the former definition of trade receivables.

34. Mr. MORÁN BOVIO (Spain) was in favour of the proposal, which he believed would be an important addition to the text of draft articles 11 and 12. Referring to paragraph 104 of the analytical commentary (A/CN.9/470), he said the intention of the secretariat was to prevent a debtor from avoiding an original contract on the sole ground that the assignor had breached an anti-assignment clause. However, he was anxious to ensure that the definition of the excluded practices was not too restrictive. He suggested that the list of excluded receivables could be extended to cover receivables arising from "other similar" practices, as well as those listed. Such an addition would make provision for new practices which might yet emerge. He also wondered whether commercial rents would be covered in the list.

35. Mr. DOYLE (Observer for Ireland) preferred to confine the list to trade receivables. The text of the proposal responded to serious concerns raised by the banking industry in his country about draft articles 11 and 12, the scope of which was contrary to its practices. The suggestion by the representative of Spain, however, would involve a renewed debate on policy issues, which would be risky at the current juncture.

36. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) said that the subjects to be covered by the exclusions had already been fully discussed and agreed upon. He did not favour departing from the text of the United States proposal, which made clear that the practices covered all fell under the heading of service provision.

37. The CHAIRMAN said that the point just raised could be made in the commentary to the draft articles.

38. Mr. COHEN (United States of America) agreed with the representative of Spain that it was necessary to pay heed to the remarks by the secretariat in paragraph 104 of its analytical commentary (A/CN.9/470). As for his suggestion to include "other similar" receivables in the list proposed in document A/CN.9/XXXIII/CRP.8, such an inclusion, rather than being helpful, might engender uncertainty.

The meeting was suspended at 4.30 p.m. and resumed at 5 p.m.

39. Mr. TELL (France) observed that continuously whittling down the scope of the draft Convention diminished its value. The pattern of the recent UNCITRAL decisions had been to have the Convention apply only when banks were the creditors, not when they were the debtors. His delegation would not oppose consensus on the United States proposal regarding draft articles 11 and 12. However, it disagreed with the views of the Spanish representative regarding paragraph 104 of the commentary and favoured retaining article 11 as currently worded.

40. Ms. STRAGANZ (Austria) said that her Government's long-standing concerns about draft articles 11 and 12 might conceivably stand in the way of its ratifying the Convention. Her delegation did not object to the United States proposal in relation to article 11 but failed to see why article 12 should be similarly restricted.

41. Mr. SCHNEIDER (Germany) proposed the addition of the phrase "..., including construction contracts" at the end of subparagraph *(a)* of the United States proposal, because in some

European States the law distinguished between the provision of services and such contracts. The matter was one that could be left to the Drafting Group.

42. His delegation agreed with the Austrian delegation that the United States proposal should be made to apply only to article 11; otherwise, the kinds of receivables covered by the important rule in article 12 would be too severely limited.

43. His Government had always considered that the draft Convention should facilitate industrial netting agreements rather than interfere with them. The anti-assignment clauses as drafted would be a hindrance. His delegation therefore proposed qualifying subparagraph *(a)* of the United States proposal by making an exception for an original contract governed by a netting agreement.

44. Mr. SALINGER (Observer for Factors Chain International (FCI)) said that he was disturbed by the proposed German amendment that would exclude netting agreements, for that would negate the purpose of article 11 and would open the door to enormous frauds against factors and discounters. His organization had seen many attempts at fraud where a supplier assigned trade receivables to a factor and then arranged that the debtors' obligations to pay one of its associated companies would be set off. Such fraud was averted only by the rules relating to the notification that must intervene. If suppliers could make such arrangements and at the same time make effective an anti-assignment clause, factors would find themselves in a predicament. If the German amendment had in mind only properly organized netting agreements in trade markets, it would not be a problem; but if it covered every kind of netting arrangement, it would give rise to real difficulties.

45. Ms. LADOVÁ (Observer for the Czech Republic) said that she shared the serious concerns of the Austrian delegation. Under Czech law, violation of an anti-assignment clause invalidated the entire assignment contract. There should be a possibility for States parties to enter a reservation to article 11. The provisions of article 12 in either its original or its amended form did not solve the problem.

46. Mr. COHEN (United States of America) said he agreed that the reference to article 12 in his delegation's proposal should be restricted to article 12 (2) and would revise the text accordingly. The German proposal to include a specific reference to construction contracts did not represent a policy change and could also be accommodated, since the listing in subparagraph *(a)* had been intended to be inclusive for all States and languages.

47. Regarding Germany's concern about industrial netting agreements, which had not been excluded under article 6 because they did not come under financial contracts, he recalled that during an earlier discussion the observer for Canada had suggested a way of dealing with such concerns under article 20. The Canadian solution would not cause the potential problems described by Factors Chain International.

48. As to the question of the inclusion of articles 11 and 12 (2), he hoped that the Commission would not reopen the issue, which had been debated at great length during the sessions of the Working Group.

49. Mr. DOYLE (Observer for Ireland) urged the Commission not to unravel the work done in the past. His delegation was sympathetic to the concerns expressed by the Austrian representative and the observer for the Czech Republic, because Ireland's own industry had the same problems. However, the Commission could not go back on the Working Group decision that articles 11 and 12 were integral to the draft Convention, and the best that could be done would be to limit their scope somewhat. The proposed United States amendment to the two articles appeared to be the best compromise available. If the German proposal regarding the inclusion of construction contacts was merely a drafting proposal, he would support it. Germany's proposal regarding netting agreements, however, reopened a question of policy. The secretariat proposal in paragraph 104 of the commentary on article 11 also seemed to be reopening a policy matter that had been decided in article 11 (2).

50. Mr. IKEDA (Japan) said that he supported the statements made by the Austrian and German representatives. Since only paragraphs 2 and 3 of article 12 corresponded to article 11, the United States proposal should be limited to the application of article 11 and article 12 (2) and (3).

51. Ms. McMILLAN (United Kingdom) said that while it was true that the discussion on such fundamental provisions as articles 11 and 12 must not be started from scratch again, certain significant difficulties that had arisen in connection with those articles could not be dismissed outright. They must at least be considered at the current session and perhaps dealt with under other articles still to be adopted. Her delegation, for example, had a problem with the wording of article 38, to be read in conjunction with article 11: it doubted that the government exclusion provided for in article 38 would be helpful where the debtor was a so-called special-purpose vehicle and as such a commercial entity set up under a commercial contract.

52. Ms. WALSH (Observer for Canada), referring to the German proposal concerning netting agreements, recalled that her delegation had proposed the previous week that the problem should be dealt with through the addition in article 20 (1) of an express reference to the preservation of rights of set-off and defences arising under a netting agreement which applied to the original contract. She would be happy to discuss a possible formulation with the German delegation.

53. Mr. MORÁN BOVIO (Spain) endorsed the comments made by the observer for Ireland. Draft article 11 had been worked on extensively by the Working Group and had been dealt with in each of the Group's reports. Those delegations which still had reservations about the provision should consult the business leaders in their countries, who supported a rule like the one in article 11, which provided them with an excellent means of financing. The provision was important and should be retained.

54. If the Drafting Group could find a way to incorporate in the United States proposal (A/CN.9/XXXIII/CRP.8) an express reference to construction contracts as suggested by the German delegation, that would be useful. It was essential, however, that the draft Convention should include a clause like the one proposed by the secretariat in paragraph 104 of document A/CN.9/470, so that the debtor could not declare the contract avoided on the ground that the anti-assignment clause had been violated, because otherwise draft article 11 would be of no use whatsoever.

55. Ms. McMILLAN (United Kingdom) said that one of her delegation's difficulties with draft article 11 related to privately financed initiative contracts, which had been relatively unknown in 1995, when work on the draft Convention had begun, but had since become important.

56. Mr. PALMIERI (Observer for the Commercial Finance Association) endorsed the comments made by the representative of Spain concerning paragraph 104 of the commentary and expressed appreciation for the secretariat's explanation that nothing in draft articles 11, 12 or 20 would give the debtor the right to claim that the underlying contract could be avoided because of a breach of an anti-assignment clause.

57. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) said that the aim of the draft Convention was to provide more affordable credit. The Commission should not only examine the approaches taken by various countries but also look at the economic effects of the draft Convention. In Germany, after the abolition of anti-assignment clauses, the factoring industry had experienced double-digit growth. That was the kind of effect the Commission was trying to achieve.

58. Mr. IKEDA (Japan) said that his delegavion had no problem with the United States proposal in relation to draft article 11; however, it saw difficulties in applying it to draft article 12.

59. The CHAIRMAN said that a number of important issues had been touched upon so far. First, paragraph 104 of document A/CN.9/470 contained a suggestion by the secretariat on how to address the issue arising from the wording of draft article 11. There appeared to be broad support for that proposal; however, some delegations had reservations that went beyond drafting suggestions. Draft article 11 had been worked on extensively by the Working Group and was one of the core provisions of the draft Convention. Some delegations believed that it should not have a place in the draft Convention, while others believed that it should be an opt-out provision. However, that was contrary to the view of the Working Group. He asked whether any of the delegations that objected to the proposal contained in paragraph 104 of document A/CN.9/470 had alternative proposals.

60. Second, there was broad support for the German request that a specific reference to construction contracts should be included in paragraph *(a)* of the United States proposal (A/CN.9/XXXIII/CRP.8). That issue appeared to be settled.

61. Mr. DOYLE (Observer for Ireland) said that, following the discussion, his delegation was now satisfied that the secretariat's proposal was necessary and was prepared to withdraw its reservations concerning paragraph 104.

62. Mr. TELL (France) reiterated his delegation's opposition to the secretariat's proposal. The question of anti-assignment clauses was one of the first questions that had been dealt with by the Working Group. It would be preferable to avoid reopening the debate on a provision that had, as the representative of Spain had stated, been included in all previous reports. His delegation could not understand why such concerns were being raised at such a late stage in the debate. It was greatly taken aback by the proposal, which implied fairly significant legislative changes for States. It was not for delegations which had reservations concerning the proposal to put forward alternative proposals; it was for those who believed that such changes were necessary to make proposals that could be supported by the Commission.

63. A balance had been achieved on the question of anti-assignment clauses, as reflected in draft article 11 (1) and the first sentence of (2). If the Commission went beyond the text as drafted, it risked putting too much weight on one side of the scale.

64. The CHAIRMAN said that the Commission was discussing the secretariat proposal because some delegations supported it.

65. Mr. MORÁN BOVIO (Spain), replying to the representative of France, said that his delegation was not opposed to the underlying idea of draft article 11; it merely wished to supplement it with the secretariat proposal in paragraph 104.

66. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices), replying to the representative of France, said that even if the draft Convention was silent on the question of anti-assignment clauses, there was still the problem of interpretation. There were a number of provisions in the draft Convention which led to the conclusion that cancelling a contract for breach of an anti-assignment clause would not be possible even if the draft Convention was not explicit on the subject.

67. Draft article 11 provided that an assignment was effective despite an anti-assignment clause. Draft article 20 (3) provided that the debtor could not raise a breach of contract by the assignor against the assignee as a matter of set-off. Draft article 22 provided that, after notification of an assignment, the debtor could not have the original contract modified. If modification was not possible after notification, it could be argued that cancellation was not possible.

68. Accordingly, the secretariat had considered that the matter should be brought to the attention of the Commission, especially as the Working Group had discussed it briefly but had not focused on it for lack of time.

69. The CHAIRMAN said that another issue which appeared to be nearly settled was the extent to which the proposal in document A/CN.9/XXXIII/CRP.8 should apply to draft article 12. There appeared to be broad support for the view that it should apply only to paragraph (2) and possibly paragraph (3) of draft article 12. He suggested that the Japanese and United States delegations should hold consultations on the matter.

70. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said it was his understanding that the Commission wished the commentary on the draft Convention to make clear that interbank payments systems required at least three banks to be involved in the system. In particular, it would be stated that the payments system established by two correspondent banks would not qualify as an interbank payments system for the purposes of draft article 4.

71. Mr. COHEN (United States of America) said that the interpretation of the Secretary of the Working Group was not consistent with his delegation's understanding of the agreement reached by the Commission, which had been that no attempt would be made to limit such interbank agreements to agreements among three or more banks. Reference had been made to the use of the term in other contexts to refer to systems with three or more banks. The possible confusion over the term was the reason for the helpful drafting suggestion made earlier in the meeting by the European Banking Federation.

The meeting rose at 6 p.m.

Summary record of the 692nd Meeting

Thursday, 22 June 2000, at 10 a.m.

[A/CN.9/SR.692]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.10 a.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.8)

Chapter V

1. The CHAIRMAN said that, as previously agreed, the Commission would interrupt its consideration of article 11 so that the observer for the Hague Conference on Private International Law, who would be unable to participate in the remainder of the current session, could raise a series of issues concerning chapter V of the draft Convention (arts. 28 to 32).

2. Ms. KESSEDJIAN (Observer for the Hague Conference on Private International Law) said that, although the assignment of receivables was on the agenda of the Hague Conference, it had elected to consider the topic only in the context of a joint working group in which some members of the Commission had participated. Although some of the private international law rules established in the draft Convention did not correspond exactly to the joint working group's suggestions, they were nevertheless quite satisfactory.

3. However, chapter V raised a number of issues. If, as planned, articles 28 to 32 became a "mini-convention" available to States whose domestic legislation did not include the necessary provisions of private international law, there might be problems in cases where the conflict-of-law rules embodied in the draft Convention differed slightly from those established in the Rome Convention and other regional instruments. The Commission should endeavour to identify specific situations where such difficulties were likely to arise.

4. With regard to the scope of application of chapter V, she noted that article 1 (3) and the words "With the exception of matters that are settled in this Convention" in articles 28 (1) and 29, all of which were currently placed in brackets, would have to be reconsidered if the "mini-convention" approach were adopted. It was important to ensure that States parties could not use articles 28 and 29 as an excuse for avoiding application of the substantive law provisions contained in the rest of the draft Convention. The best solution might be to make a single such statement at the beginning of chapter V.

5. Article 28 (2) stated that, in the absence of proof to the contrary, the contract of assignment was presumed to be most closely connected with the State in which the assignor had its place of business. A similar statement might be included in article 6 in order to resolve the problem of establishing location for transactions involving branch offices of financial service providers.

6. Article 28 (3) was clearly modelled on article 3, paragraph 3, of the Rome Convention. Such a provision was appropriate to the latter instrument, which did not define the term "internationality" and could therefore be taken to apply to all contractual obligations, including domestic ones. Since the draft Convention contained such a definition and, except in one case, applied only to international assignments, article 28 (3) might cause more problems than it solved.

7. Furthermore, if the Commission elected to establish chapter V as a "mini-convention", an explicit exclusion of renvoi must be added to article 28 and the comments on the ambit of the draft Convention (A/CN.9/470, para. 191) must be reflected in the actual text of article 28 (1).

8. She did not fully understand the role of article 30, which had been placed in brackets; even if the Commission took the "mini-convention" approach to chapter V, article 30 should be drafted along the same lines as article 24 for the sake of consistency. In any case, she found it redundant to include both article 30 (2) and article 32 in the draft Convention.

9. Mr. FERRARI (Italy) agreed with the comments made by the observer for the Hague Conference concerning the private international law rules not covered in chapter V. Although he was not in favour of establishing articles 28 to 32 as a "mini-convention", he agreed that such an approach would require the redrafting of other articles.

10. He thought that the exclusion of renvoi had been dealt with in article 6 *(j)*, although it was true that under the "mini-convention" approach that article would not apply to private international law rules. However, under article 1 (3) in its current form, those rules would remain in force regardless of the applicability of the draft Convention, in which case the concerns raised by the observer for the Hague Conference would need to be addressed.

11. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that articles 30, 31 and 32 had been placed in brackets pending the finalization of articles 24 to 27. Articles 30 (2) and 32 were indeed very similar; the Working Group had decided to model the substance of article 30 on article 24 for reasons related to the scope of the draft Convention. The Commission would have to resolve that problem at a later date.

Article 11

12. The CHAIRMAN invited the Commission to resume its consideration of article 11 and, in particular, the secretariat proposal contained in paragraph 104 of the analytical commentary to the draft Convention (A/CN.9/470).

13. Mr. MEDIN (Observer for Sweden) suggested that the Commission should first decide whether to delete article 11. Anti-assignment clauses were effective under Swedish domestic law; the country's industries were strongly in favour of retaining that article, which they considered to be the instrument's most important provision.

14. If article 11 was retained, it would be appropriate to state therein that the debtor could not declare the original contract avoided on the sole ground that the assignor had violated an anti-assignment clause.

15. Mr. MORÁN BOVIO (Spain) said that he would prefer to retain article 11, which made it clear that an assignor who violated an anti-assignment clause was responsible to the debtor and that the draft Convention did not affect national restrictions on such clauses. He also supported the secretariat proposal; in case of uncertainty concerning the interpretation of article 11 (2), the proposed amendment would make the assignee's position secure.

16. The CHAIRMAN said that, since the Working Group had already approved article 11, it would be retained unless there was strong support for its deletion.

17. Mr. DOYLE (Observer for Ireland) said that inevitably there were provisions in the draft Convention that certain delegations might find strange or unacceptable. He fully sympathized with those delegations which found article 11 alien to their national systems, as the same objection had been raised in Ireland. However, for States to ask for a provision to be removed for that reason was an indulgence which the Commission could not afford. The secretariat proposal in paragraph 104 was a valuable clarification of article 11. The debtor's remedies should be preserved, but should not include avoiding the original contract, or article 11 would be meaningless.

18. Mr. BURMAN (United States of America) noted that the Commission's aim was to adopt a modern approach to encourage the extension of credit to areas of the world where it was urgently needed. Certain core provisions of modern finance law had to be included; if a provision of the text was inconsistent with a domestic law, a country always had the option not to implement the instrument. The alternative of watering down critical provisions that were vital to the draft Convention was unacceptable. His delegation would explain to lawmakers why the Convention differed from domestic law and some elements of that law would need to be changed. If at each meeting a delegation could object to a provision inconsistent with its national law, the Convention would not be ready until 2005 instead of 2001.

19. On the basis of the discussion, his delegation agreed with the solution proposed in paragraph 104 of document A/CN.9/470.

20. Ms. STRAGANZ (Austria) clarified that her delegation did not wish to delete or question article 11, which was a key provision of the draft Convention. It was unlikely that it would be misinterpreted, as businessmen were likely to go to courts where the issues involved were understood. Her Government did still have concerns, and she had therefore expressed them, but her delegation accepted the proposal in document A/CN.9/XXXIII/CRP.8, as well as the proposal in paragraph 104 of the commentary.

21. Mr. CARSELLA (Observer for the Commercial Finance Association) said that members of the Association who financed those types of receivable were concerned that they might have to review individually vast numbers of receivables in order to determine which ones could be financed. Such an onerous task would result in the banks refusing to offer financing, which would defeat the purpose of facilitating low-cost financing to businesses around the world.

22. Mr. MARADIAGA (Honduras) said that the arguments for retaining article 11 had been convincing. However, the principle of good faith was very important in contractual law, in the context of negotiations and also in the execution of contracts. He wondered what would happen if the third party referred to in article 11 (2), was deliberately trying to cause harm.

23. Mr. FRANKEN (Germany) was in favour of retaining article 11 and also believed that the secretariat proposal in paragraph 104 should be included to cover contracts concluded for a long period of time. When an anti-assignment clause had been breached, the debtor should perhaps have the right, in addition to a claim for compensatory damages, to terminate such a contract. If the Commission did not agree with that course of action, his delegation would in any case accept the proposal in paragraph 104.

24. Ms. McMILLAN (United Kingdom) understood that paragraph 104 offered two alternatives: limiting the relief available to the debtor against the assignor for breach of an anti-assignment clause to a claim for compensatory damages, or stating that the debtor might not declare the original contract avoided on the sole ground that the assignor had violated an anti-assignment clause.

25. Article 11 did not require amendment; however, if there was a consensus in favour of change, she would prefer the second alternative. The first one seemed interventionist, as it was unclear whether compensatory damages would be what the debtor would wish.

26. Mr. STOUFFLET (France) supported the current wording of article 11; it seemed unnecessary to be more specific about the risk of avoidance of the contract at the request of the debtor. There should be no such risk, because paragraph (1) provided absolute protection to the assignee against all the possible consequences of a breach of an anti-assignment clause. Any addition was superfluous, and could have unexpected and undesirable effects. A contract was often a complex matter with numerous obligations, of which only the monetary obligations were transferred to the assignee. In relations between the assignor and the debtor, it might be desirable under domestic law to allow the contract to be cancelled. That could be a way for the debtor to obtain the cancellation of contractual obligations other than the monetary obligations that had been transferred. Sometimes, several contracts were interlinked and failure to perform an obligation arising from one contract could have the effect of annulling a whole series of contracts. The Commission should also consider cases where the assignment was not total, as in the case of successive contracts for a lease, where there was an obligation to pay rent due each month or year. It was quite possible that the assignment related only to part of the monetary obligations under the contract. Why prevent termination at the request of the debtor? The first paragraph of article 11 was sufficient to prevent there being any consequence for the assignee; the issue would be the relationship between the assignor and the debtor, and the law regulating their obligations.

27. Mr. MEENA (India) said that the first paragraph of article 11 had an overriding effect on contractual arrangements. Paragraph (2) did not intend to lift the limitation on assignment so that the assignor was not liable for a breach of agreement between the assignor and the debtor. It attempted to protect any assignee or related person which was not a party to the agreement between the assignor and the debtor, by ruling out liability on the sole ground that such a person had knowledge of the agreement.

28. His delegation accepted article 11 as well as the secretariat proposal in paragraph 104.

29. Mr. HERRMANN (Secretary of the Commission) wished to clarify the secretariat proposal in paragraph 104. The draft Convention did not need to address the issues of good faith or

malicious intent, because there were already general principles of law to deal with those issues. Article 11 (2) referred to possible consequences, despite the assignment being effective, and seemed to require the additional clarification that breach of an anti-assignment clause was not a basis for avoiding the contract. The intent was to exclude only the right to terminate the contract and not positively to regulate what the consequences would be, as the United Kingdom representative had pointed out. The exclusion of the right to avoid a contract on the sole ground of violation of an anti-assignment clause would take care of the example of a partial assignment. If there was a right to avoid the contract because of connections with other contracts, the exclusion would not operate.

30. Mr. AL-NASSER (Observer for Saudi Arabia) also supported article 11, but had some concerns about the first paragraph. He proposed adding the words "unless there is an anti-assignment clause under the law of the country concerned".

31. Mr. ATWOOD (Australia) supported the secretariat proposal in paragraph 104, which would clarify the interaction between paragraphs (1) and (2) of article 11. His delegation preferred the second of the two alternatives in paragraph 104, namely to restrict the debtor's right to avoid the contract.

32. The CHAIRMAN recalled the secretariat clarification that the proposal in paragraph 104 did not place any limitation on remedies available to the debtor for breach of an anti-assignment clause by the assignor. The aim was to ensure that the contract was not terminated purely because of the breach of such a clause. If that policy direction was accepted, the drafting group could decide on the wording.

33. Mr. IKEDA (Japan) said that his delegation was in favour of adopting article 11 as currently worded.

34. Mr. FRANKEN (Germany) also approved the present wording of article 11. However, in a contract concluded for a longer period of time, there seemed to be no reason why the debtor should not terminate a contract because of the breach of an anti-assignment clause. It would certainly have that right under German law. The purpose of article 11 was to protect the assignee, by making the assignment valid despite any anti-assignment clause. However, there was no intention of protecting the assignor. That was a matter of policy rather than drafting.

35. The CHAIRMAN confirmed that it was a policy matter that still had to be settled. However, there seemed to be a consensus to retain the provision to negate anti-assignment clauses.

36. Mr. TELL (France) said that the secretariat clarification had only increased his delegation's concern. The secretariat had said that a contract could not be avoided on the ground of breach of an anti-assignment clause. Paragraph 104 also made that clear. He shared the view expressed by the representative of Germany. Such interference with domestic law would make ratification very difficult. His delegation was prepared to accept article 11, which would require modifying national legislation to ensure that anti assignment clauses would not have any effect on the assignee as far as cancellation was concerned. However, to specify that the debtor had no possibility of avoiding a contract when an anti-assignment clause had been violated was going too far.

37. The CHAIRMAN suggested that, since there appeared to be broad support for retaining article 11, the Commission should focus on the need to include in the text wording that explicitly excluded the right of the debtor to terminate its contract with the assignor because of a breach by the latter of an anti-assignment clause.

38. Mr. COHEN (United States of America) reiterated his delegation's support for the incorporation in article 11 of wording along the lines proposed by the secretariat in paragraph 104 of the analytical commentary to the draft Convention (A/CN.9/470). The point made therein was a very important one. The purpose of article 11 was to protect the assignee against the assertion of a non-assignment clause. If, however, the debtor could avoid the contract on the sole ground that the assignor had violated such a clause, the outcome for the assignee would be the same as if a non-assignment clause were given effect. In both cases, the assignee would have purchased a receivable of no practical value. Unless assignees were afforded the protection that article 11 was intended to provide, they would have to examine the documentation of each individual original contract in a bulk assignment and the resulting expense would be passed on to debtors.

39. Mr. DOYLE (Observer for Ireland) said that, if article 11 was to work, it must negate any anti-assignment clause. It was true that the secretariat proposal would constitute major interference in contract law, but that could not be avoided. It was difficult to square the opposition of certain speakers to the wording proposed in paragraph 104 with their assertion that they wished to protect the rights of the assignee vis-à-vis the debtor. Maintenance of the debtor's right to terminate a contract on the sole ground of violation of an anti-assignment clause would vitiate article 11.

40. Ms. GAVRILESCU (Romania) said that her delegation wished to associate itself with the views expressed by the representative of France. The Working Group had debated the provisions of article 11 at length. The language used in the draft Convention had enjoyed consensus and should therefore be retained as it stood. She saw no need for the wording proposed by the secretariat.

41. Ms. SABO (Observer for Canada) endorsed the comments of the United States representative and supported the incorporation in article 11 of the wording proposed by the secretariat in paragraph 104.

42. Mr. HERRMANN (Secretary of the Commission) urged those members of the Commission who wished to retain article 11 as it stood to indicate clearly their interpretation of paragraph (1). It was very important to clarify the extent to which rights accorded to debtors under national laws were excluded.

The meeting was suspended at 11.45 a.m. and resumed at 12.15 p.m.

43. Ms. McMILLAN (United Kingdom) said that delegations appeared to be very far apart in their interpretation of article 11. It seemed that the representatives of France and Germany saw that article as allowing the debtor to avoid a contract in the event of a violation by the assignor of an anti-assignment clause. Such an interpretation ran counter to the purpose of article 11: if the debtor could terminate the contract by relying on an anti-assignment clause, its willingness to discharge the debt would be diminished. It was clear from the Commission's discussions that article 11 was open to various readings and that its adoption as it stood would lead to complicated litigation between debtors, assignors and assignees.

44. Mr. FRANKEN (Germany) said that under many national laws debtors had the right to terminate long-term contracts to

which they were party in the event of a material breach of the contract. That right should not be taken away. He proposed the incorporation in paragraph (1) of a clause to the effect that the debtor might not declare the original contract avoided on the sole ground that the assignor had assigned the receivables arising from it in violation of an anti-assignment clause, unless the assignment constituted a material breach of the contract. He emphasized that such a provision would apply only in the case of future receivables and not in the case of receivables that had already crystallized.

45. Mr. BRINK (EUROPAFACTORING) said that his delegation concurred with the observer for Ireland and the representatives of the United Kingdom and the United States in their interpretation of article 11. It seemed that other delegations wished to restrict the application of the article to an extent that would undermine the purposes of the draft Convention and limit, rather than promote, the assignment of receivables. He was not convinced that those delegations had understood the thrust of the secretariat proposal: while excluding the right of the debtor to terminate the contract on the sole ground that the assignor had violated an anti-assignment clause, it would not affect its right to do so for any other reason. The Commission must keep in mind that any provision of the draft Convention that undermined the value of the receivable would be detrimental to the assignee.

46. Mr. STOUFFLET (France) said that his delegation had no desire to tamper with the principles underlying the law of contracts. Clearly, the rights of the assignee must be inviolable. However, there was no need, in order to achieve that end, to prohibit avoidance of the original contract as a sanction for violation of an anti-assignment clause. Maintaining the right of the debtor to avoid the contract would in no way undermine article 11.

47. Mr. COHEN (United States of America) said that the differences of opinion concerning the provision proposed in paragraph 104 were more apparent than real, since they centred on differences in the kind of transaction that each delegation envisaged and different understandings of the words "sole ground". In fact, however, there was full agreement that, where an assignor had fulfilled all its obligations and it only remained for the debtor to pay, the latter was not entitled to terminate the engagement. If, on the other hand, an assignor assigned all its rights under a contract to a third party, who failed to fulfil the contract, the debtor had every right to avoid the contract. United States law drew a distinction between assignments of the right merely to be paid, where there was no delegation of performance to the assignee and no harm done to the debtor, and those which materially changed the debtor's duty, increased its risk or impaired its ability to obtain performance. The policy had surely been agreed and the drafting group could be requested to find the right wording. The proposal adumbrated by the German delegation and given formal expression by the Chairman was not wholly satisfactory: if the key element in the original contract was that it was not to be assigned, subsequent assignment might be claimed to be a material breach of the contract. That was surely not the aim of the proposal, which rather sought to deal with instances in which the debtor was caused material harm because the assignment delegated duties to the assignee or otherwise impaired the debtor's right to get what it was entitled to.

48. Mr. MORÁN BOVIO (Spain) said that the debate illustrated the relevance of the provision proposed in paragraph 104, which went to the very heart of the draft Convention. By addressing the relationship between the assignor and the assignee, the Commission was impinging on domestic law either as codified or as expressed in a contract, since it excluded any possible interference in that relationship in cases where the contract contained an anti-assignment clause. It was therefore important that the draft Convention should contain a provision that non-compliance with an anti-assignment clause would not allow a debtor to declare a contract terminated. Such a provision would undoubtedly impinge on domestic law; but it might be necessary to go still further and stipulate that the debtor would have no monetary rights other than those arising out of the contractual relationship. The suggestion by the representative of Germany that assignments under long-term contracts, involving receivables yet to arise, might not be covered by article 11, was damaging to the agreement reached on that article, since the effect of the article would be undermined by any implication that some kinds of contract fell outside its scope. Nothing should be done to discourage assignors from assigning receivables, even ones that had not yet arisen, in long-term contracts. The draft Convention already made it clear that assignment did not alter any of a debtor's rights and, indeed, could actually improve a debtor's position. The example given by the United States representative was irrelevant, in that it related to the performance of the original contract. Article 2 concerned receivables arising from the original contract, which was quite another matter, even if it contained an anti-assignment clause.

49. Mr. DOYLE (Observer for Ireland) said that earlier discussions of the same point had not raised such difficulties. He understood the reservations of the French delegation, although it was hard to see how the assignee's rights against the debtor could be protected if the original contract no longer existed. The subject of the draft Convention was simply the assignment of the right of payment—hence the expression "sole ground"—and not any other contractual obligations. As for the German suggestion, he too wondered why a distinction should be made between future receivables and receivables that had already crystallized. Moreover, the interpretation of the expression "material breach" gave rise to great difficulties. Its use might therefore cause more problems than it solved. He would still prefer a text based on that proposed in paragraph 104.

50. Ms. GAVRILESCU (Romania) stressed that before any decision could be reached the Commission would need to see the written text of any proposal.

51. Mr. SALINGER (Observer for Factors Chain International) agreed with previous speakers that paragraph 104 concerned a core provision of the draft Convention. He had believed that, rather than dealing with the delegation or transfer of responsibility under a contract, the draft Convention concerned only the assignment of receivables. The objection to prohibiting the termination of a contract owing to the breach of an anti-assignment clause stemming from the fact that the performance of the assignee rather than that of the assignor was at fault was therefore irrelevant. As for the question of a material breach, the claim could be made that the breach was material if the contract referred to it as such. If, however, the draft Convention contained a provision that a contract could not be terminated except in respect of future receivables, the effect might also be to cancel out existing receivables, because under article 20 some contracts might allow for counterclaims by the debtor which could be set off against existing receivables. The assignee would therefore be left with nothing. If the Commission was interested in assisting the financing of trade receivables and obviating the need for financers to examine every contract, it would be well advised to include in the draft Convention the provision proposed in paragraph 104.

The meeting rose at 1 p.m.

Summary record of the 693rd Meeting

Thursday, 22 June 2000, at 3 p.m.

[A/CN.9/SR.693]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 3.05 p.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.4 and 6-8)

1. Mr. TELL (France), replying to a statement made at the previous meeting by the United Kingdom representative, said that under the French Constitution, any international instrument ratified by France prevailed over national law. Thus, a provision like the one contemplated in paragraph 104 of document A/CN.9/470 would supersede the general principles of contract law in the French Civil Code. The fear expressed by the representative of Spain that the wording proposed by the German delegation would conflict with national law could just as easily be expressed with regard to the secretariat suggestion. The only difference was that, under the German proposal, the possibility for the debtor to terminate the contract would be subject to the condition that there was a grave material breach of the contract.

2. It was one thing to state that the debtor did not have the right to avoid the contract on the ground that an anti-assignment clause had been violated; it was another thing to state, as in draft article 11, that the assignment of a receivable was effective notwithstanding the violation of any anti-assignment clause. For that reason, his delegation proposed that the following should be inserted after article 11 (1): "The avoidance of the original contract by virtue of such an assignment has no effect, in particular, on the rights acquired by the assignee against the debtor."

3. Ms. WALSH (Observer for Canada) said that she shared the concerns expressed by previous speakers with regard to the wording proposed by the German delegation and believed that paragraph 104, as drafted, adequately expressed the underlying idea of draft articles 11 and 12.

4. Mr. COHEN (United States of America) said that, while his delegation also supported the policy reflected in paragraph 104, it was mindful of the numerous problems identified by some delegations which were not comfortable with that paragraph without fuller explanation. Many of those problems arose from long-term contracts where the assignor might owe some obligations to the debtor. While some delegations had pointed out earlier that the draft Convention dealt only with assignment of receivables and not with delegation of duties, many contracts combined both and used "assignment" as a blanket term.

5. In order to clarify the intention in paragraph 104, his delegation proposed that in the bracketed part of the fourth sentence of that paragraph, after the words "or that the debtor may not declare the original contract avoided on the sole ground that the assignor violated an anti-assignment clause", the following should be inserted: "unless the assignment materially impairs the debtor's ability to obtain performance owed to the debtor under the original contract. An assignment merely of the assignor's right to payment, and that has not delegated any duties owed to the debtor by the assignor, does not materially impair the debtor's ability to obtain performance owed to the debtor under the original contract".

6. The CHAIRMAN said he was not certain that the United States proposal was consistent with the secretariat's proposal. He also requested the United States delegation to consider whether its proposal addressed the concerns expressed by the French delegation.

7. Mr. DOYLE (Observer for Ireland) expressed appreciation to the French delegation for attempting to move the issue along. Nevertheless, he failed to see how it would be possible to avoid the original contract and preserve the assignee's rights against the debtor. It was his understanding that the assignee's rights depended on the original contract. If there was no original contract, it was unclear how there could be a valid assignment.

8. All delegations understood that draft article 11 would present difficulties for certain delegations. If, however, there was a consensus in the Commission that the draft article was broadly acceptable, then those delegations, which included his own, would have to accept it.

9. With regard to the United States proposal, it was his understanding that draft article 11 dealt only with rights of payment. The only thing that the assignee wished to gain through assignment was the right to payment and the only concern of the debtor was the transfer of the duty to pay. He failed to grasp why it was necessary to deal with performance rights at all, and he therefore supported the secretariat's proposal.

10. Mr. MORÁN BOVIO (Spain) said that he was almost fully in agreement with the statement made by the observer for Ireland. It was important to draw a distinction between the text proposed by the secretariat, which was limited and very specific, and the proposal made by the German delegation, which would fully open up the possibility of avoidance of the contract based on how the anti-assignment clause was classified. The French proposal was therefore inadequate. As to the United States proposal, it could be included in the commentary, but he was in favour of leaving paragraph 104 as drafted.

11. Mr. FERRARI (Italy) said that, like the observer for Ireland, he did not believe that performance rights should be addressed and did not support the United States proposal. He agreed with the representative of Spain that the best way to deal with draft article 11 was to retain it as drafted or to insert in it wording from paragraph 104.

12. Ms. WALSH (Observer for Canada) said that she shared the concerns expressed by the observer for Ireland and the representative of Italy that the United States proposal might expand the intended scope of draft article 11.

13. Mr. FRANKEN (Germany) said that his delegation could accept either the United States proposal or the French proposal. If it was decided to retain the commentary, his delegation could also accept the wording proposed by the secretariat in paragraph 104.

14. The CHAIRMAN said that a number of delegations strongly supported the secretariat's proposal. Within that group, however, some delegations believed that the commentary should reflect certain views, while others wished to see a paragraph (3) added to draft article 11 in order to reflect the understanding that draft article 11 was itself subject to certain exceptions.

15. Normally, in a situation where there was no consensus, the text would remain as drafted, but as there appeared to be different understandings of what draft article 11 (1) was intended to mean, he was reluctant to close the debate without a clear direction being taken by the Commission as a whole.

16. Mr. MORÁN BOVIO (Spain) said that in his opinion, the debate on the question was already closed. The German delegation had indicated that it had no difficulties with the text in paragraph 104 or with wording similar to what the United States delegation had proposed.

17. The CHAIRMAN said that it was necessary to clarify what was to remain in the commentary. The United States proposal was now supported by the German delegation, but that proposal differed somewhat from what was in paragraph 104. There was as yet no consensus on what policy was to be reflected in the commentary. He also wished to know whether there was any support for the French proposal.

18. Mr. COHEN (United States of America) said he agreed with the representative of Spain that the Commission was moving towards consensus on draft article 11 as supplemented by the secretariat's point in paragraph 104. His delegation did not believe that its proposal was inconsistent with that paragraph; it was merely intended to explain the meaning of the phrase "on the sole ground". It was for the Commission to decide whether it preferred that phrase or the somewhat lengthy explanation proposed by his delegation. His delegation would be satisfied with either choice. It would be troubled, however, if draft article 11 was not supplemented by any of the wording in paragraph 104.

19. Mr. DESCHAMPS (Observer for Canada) requested the French delegation to clarify whether the effect of its proposal would be that, despite avoidance of the contract, the assignee could claim from the debtor receivables assigned under the assignment.

20. Mr. STOUFFLET (France) said it was his delegation's intention that, irrespective of possible avoidance, the assignee should retain all rights as against the debtor.

21. Mr. SALINGER (Observer for Factors Chain International) said that he wished to illustrate the point made by the observer for Ireland. If the assignee took assignment of the assignor's contract to sell goods over a period of a year, he would be selling one existing receivable and 11 future receivables. If the debtor was able to avoid the contract, his right to those future receivables must necessarily be affected. Accordingly, the French proposal did not resolve the issue. Either the debtor must not be allowed to avoid the contract, or, in the absence of agreement, the text should be left as it was.

22. Mr. DUCAROIR (Observer for the European Banking Federation) said that if the debtor was allowed to avoid the contract under the conditions proposed, the future assignment would have no effect on the assignee, who was frequently a banker. He therefore shared the concerns expressed by the observer for Factors Chain International.

23. Ms. McMILLAN (United Kingdom) said that the current debate was very confusing. Her delegation supported the views expressed by the observers for Ireland and Factors Chain International. Either draft article 11 should be left as it was, or wording should be added to specify that the debtor could not declare the original contract avoided on the sole ground that the assignee had violated an anti-assignment clause. Anything more complicated would mean that the draft article would have no cost advantage at all, as it would simply give rise to litigation.

24. The CHAIRMAN said that, as there appeared to be no support for the French proposal, draft article 11 would remain as drafted. The only issue was how to explain it in the commentary. The United States delegation had suggested that its wording, to which the German delegation had agreed, could be combined with the secretariat's proposal in paragraph 104.

25. Ms. WALSH (Observer for Canada) said it was clear from the debate that all that was required was to add the words proposed by the secretariat to draft article 11.

26. Mr. FERRARI (Italy) said that the sentiment in the Commission was not as the Chairman had described. One delegation was in favour of the United States proposal; four had spoken against it; and one was in favour of the proposal in paragraph 104.

27. Mr. DOYLE (Observer for Ireland) said that he agreed with the three previous speakers and had no objection to the wording proposed by the United States being included in the commentary.

28. Ms. GAVRILESCU (Romania) said that her delegation, like those that had spoken previously, believed that draft article 11 should be supplemented by the secretariat's proposal.

29. Mr. RENGER (Germany) said that his delegation could accept the secretariat's proposal, provided that the wording proposed by the United States was included in the report and on the understanding that such wording did not affect the debtor's ability to obtain performance.

30. Mr. TELL (France) said that his delegation had always supported the text of draft article 11 and believed that its scope was clear. The debate had arisen because the secretariat had put forward a proposal at such a late stage. His delegation's reservation concerning that proposal should be reflected in the summary record of the current meeting.

31. Mr. ATWOOD (Australia) said that his delegation supported the addition of the secretariat's proposal to the wording in draft article 11.

32. The CHAIRMAN said he understood that the Commission wished the drafting group to incorporate the language suggested by the secretariat in article 11 but to make clear that it was not intended to restrict any remedies the debtor might have against the assignor for violation of an anti-assignment clause. The language proposed by the United States illuminating the distinction between right to payment and performance would be reflected in the commentary.

33. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the decision just taken raised another question. Article 11 (1) related to anti-assignment agreements not only between the debtor and initial assignor but also between subsequent assignors and assignees. His question was whether the new rule that the original contract could not be avoided on the sole ground of violation of an anti-assignment clause should be extended to subsequent assignment contracts.

34. Mr. MORÁN BOVIO (Spain) said he thought that the rule should apply down the entire chain of contracts. If an assignee violated an anti-assignment clause in the assignment contract by assigning the receivables in turn, he might be liable for damages or other remedies for breach of contract, but the contract should not be avoidable on that sole ground.

35. The CHAIRMAN, hearing no other views, said he took it there was general agreement that the drafting group should devise language to reflect the policy just outlined.

36. He invited the Commission to turn its attention to article 12 of the draft Convention.

37. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that article 12 was intended to ensure that rights securing payment of the assigned receivable followed the receivable. Paragraph 1 implied that, if the right securing payment of the assigned receivable was an accessory right, it would follow the receivable without a new act of transfer. If it was an independent but transferable right, the assignor would have an obligation to make a new act of transfer. As explained in the commentary (A/CN.9/470, para. 105), whether the right was accessory or independent would be left to the law governing the right.

38. Paragraphs 2 and 3 followed the logic of article 11 and applied it to transfer of security rights, with the effect that an anti-assignment agreement would not invalidate the transfer of the security right, but liability for breach of the agreement under national law would be preserved. Paragraph 4 was intended to preserve the rights of a debtor in the case of a transfer of a possessory property right. Paragraph 5 was intended to ensure that requirements of form under the law applying to the security right were not interfered with.

39. In view of the decision to include an article on the law applicable to form, article 12 (5) might have to be aligned with article 25, so that, if a receivable was secured, the law governing the security right would govern matters of form, as opposed to the law of the assignor's location. Since the rule on form was formulated as a "safe harbour" rule, the Commission might think the point was already sufficiently clear. In any case, the matter might already have been clarified with respect to real property by the new rule regarding receivables arising from or secured by real estate.

40. Mr. MORÁN BOVIO (Spain) said that, for the sake of conciseness, the Commission should consider adopting the suggestion of the secretariat, expressed in the last sentence of paragraph 105 of the commentary (A/CN.9/470), that the second part of the first sentence of article 12 (1) from the word "unless" to the end should be deleted. The words in question were clearly superfluous, since the meaning was contained in the sentence that followed.

41. The CHAIRMAN said that, since there were no objections, the matter could be referred to the drafting group.

42. Mr. FRANKEN (Germany) recalled that, while there had been general agreement on excluding financial contracts governed by netting agreements from the draft Convention, his delegation had raised some concerns about non-financial contracts governed by netting agreements in connection with articles 11 and 12. His delegation, together with the observer for Canada and with the help of the United States delegation, had elaborated the following proposal for a partial exclusion to deal with those concerns, possibly for inclusion in article 4:

> "In the case of receivables arising under contracts governed by netting agreements, article 11 and article 12, paragraphs 2 and 3, apply only to the assignment of a receivable owed to the assignor upon net settlement of payments due pursuant to the netting agreement."

The effect would be that only the net balance after offsetting, which could become a receivable by novation, and not the component receivables, would be subject to the above-mentioned provisions of articles 11 and 12.

43. The CHAIRMAN invited the Commission to consider whether the proposal was acceptable and, if so, where in the draft Convention it should be placed.

44. Mr. SALINGER (Observer for Factors Chain International) said that his organization had no wish to prevent the proper operation of netting agreements, but he was concerned that the definition was too wide. As it stood, a netting agreement could refer to an agreement between any two parties to run a current account with complete set-off of all transactions. Under the new proposal, they could decide to enter into an anti-assignment agreement that would be effective except for the net balance. If such was the case, the provisions of article 20 whereby an assignment could intervene in the rights of set-off of unconnected transactions would have no effect. Perhaps a better definition of a netting agreement, limiting it to an organized practice in a particular trade or market, might avoid the problem.

45. The CHAIRMAN said he assumed that the dissatisfaction of Factors Chain International with the definition of netting agreement related to commercial rather than financial transactions.

46. Mr. MORÁN BOVIO (Spain) said that the observer for Factors Chain International had made a pertinent point. When the Commission had settled on a definition of netting agreement, it had had in mind financial rather than commercial transactions. He would appreciate clarification as to whether, pursuant to the proposal, articles 11 and 12 would apply to balances under netting agreements.

47. Mr. BRINK (Observer for the European Federation of National Factoring Associations (EUROPAFACTORING)) said that his Association had acquiesced in the exclusion of receivables governed by netting agreements in the financial markets because those markets were well supervised. If the exemption for netting agreements was broadened to industry and commerce, however, any commercial entity would be able to escape from the effects of article 11, which would erode the very core of the draft Convention. An assignee that had paid money for a receivable might find himself unable to claim it, and, because of that uncertainty, be less willing thereafter to make such a transaction.

48. Commerce and small- and medium-sized enterprises, especially in developing countries, were in great need of receivables financing. The industries that typically used well-organized netting agreements would not be inconvenienced by article 11 because they did not need that type of financing and would not be assigning their receivables.

49. Mr. COHEN (United States of America) said that his delegation fully supported the policies embodied in articles 11 and 12. However, legitimate concerns had been raised about the effect of the articles on the assignment of receivables governed by netting agreements of a kind not excluded from the draft Convention. Serious problems could arise, particularly with multiple assignments, if parties assigned component receivables subject to a netting agreement, but no such problem would arise with the netted amount, and article 11 could apply. That was the

thrust of the proposal formulated in the ad hoc meeting convened by the German representative and the observer for Canada.

50. The intent was to save factors or other receivables financiers from unpleasant surprises, not to put them at a disadvantage. Perhaps that problem could be addressed by adding language to the effect that the netting agreements meant were those referred to in the original contract or contract of assignment, so that the assignee had a means of knowing about them.

51. Mr. DESCHAMPS (Observer for Canada) said that a careful reading of the definition of netting agreement had convinced his delegation that a current account would not be a netting agreement within the meaning of the definition.

52. Mr. TELL (France) said he thought that the proposal for a partial exclusion needed to be made more specific by a more precise definition of netting agreement; otherwise little would be left to which article 11 applied.

The meeting was suspended at 4.35 p.m. and resumed at 5 p.m.

53. Mr. IKEDA (Japan) said that the principle underlying draft article 12 was that security rights should be treated in the same way as other receivables for the purpose of limitations on assignment. Draft article 12, paragraphs (1), (4) and (5), dealt with the kinds of security rights which might be affected by the assignment of a receivable. Only paragraphs (2) and (3) were relevant to contractual limitations on assignment. He therefore assumed that the proposal in document A/CN.9/XXXIII/CRP.8 would apply to draft article 11 and to paragraphs (2) and (3) of draft article 12. He was anxious to clarify the connection between that proposal and the Canadian-German proposal read out by the German representative earlier in the meeting. It was certainly necessary to have a special rule for netting agreements relating to assignments of commercial receivables. However, the wording was problematic, since the proposal in document A/CN.9/XXXIII/CRP.8 was essentially a list of inclusions, whereas the new proposal was exclusionary.

54. Mr. SCHNEIDER (Germany), referring to the concern expressed by the observers for Factors Chain International and EUROPAFACTORING, said that the new proposal used the term "netting agreement" according to the definition in draft article 6 *(m)* (A/CN.9/XXXIII/CRP.2). A netting agreement was invariably an agreement among three or more parties; if there were only two parties to the transaction, there would be rights of set-off between the assignor and the debtor, but the resulting balance would not be one created by a novation. In order to clarify that point, he suggested the insertion in the new proposal, after "contracts governed by netting agreements", of the words "involving more than two parties".

55. The CHAIRMAN recalled that the question of the number of parties involved in those transactions had been resolved in the course of the discussion on interbank payments systems.

56. Mr. MORÁN BOVIO (Spain) welcomed the new proposal, which made clear that receivables arising under a netting agreement, which would itself be excluded by draft article 4, could be assigned and were fully covered by draft article 11 and also, as the representative of Japan had pointed out, by draft article 12, paragraphs (2) and (3). He welcomed the proposal read out by the representative of Germany. Netting agreements were commercial not financial transactions and did not take place between credit institutions. It might therefore be desirable to define them more closely, with a view to determining how receivables arising from them should be handled.

57. The CHAIRMAN said that the Commission appeared to have agreed to accept the additional wording and must now decide where to place it. The text should perhaps be framed so as to apply to all netting agreements in the ambit of the draft Convention.

58. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) suggested that the additional wording proposed by the representative of Germany could usefully be included in the definition of netting agreements appearing in draft article 5 *(m)*.

59. Mr. SCHNEIDER (Germany) said that his intention was not to reopen the discussion on the definition of netting agreements but merely to clarify the thrust of the original proposal. However, he would have no objection to the insertion of the additional words in the definition of netting agreements in draft article 5 *(m)*.

60. Mr. COHEN (United States of America) said that he was unwilling to alter the definition of netting agreements already decided upon. The Commission had discussed at length the exclusion of financial contracts subject to netting agreements and had decided on the definition to be used for that purpose. If it now altered the definition as a result of the additional wording suggested by the representative of Germany, serious problems might arise concerning the scope of the draft Convention. He urged the Commission to accept the proposal in its original form.

61. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said the observations by the representatives of Germany and the United States showed that the definition of netting agreements could be interpreted in different ways. A similar problem had arisen with the definition of interbank payments systems, and for that reason the Commission had decided not to include the definition proposed by the observer for the European Banking Federation. As a result, the question whether bilateral payments systems were covered by the exclusion in draft article 4 would be resolved by law outside the Convention. The difference of views concerning netting agreements and the number of parties involved could be addressed in the commentary to the draft articles, if the Commission so wished.

62. The CHAIRMAN said that the Commission would have to decide whether the same considerations as applied to interbank payments systems should also apply to netting agreements.

63. Mr. SCHNEIDER (Germany) explained that the balance formed by novation as the result of a netting agreement was a new receivable and had nothing in common with the receivables involved in the netting procedure. The mechanics of netting were described in document A/CN.9/472, footnote 2. That description showed that a netting arrangement would not work if only two parties were involved. He had the impression that for the factoring industry the term "netting agreement" as used in the draft articles was not clear enough. That was why he had suggested adding the words "involving more than two parties", which in his opinion would not affect the definition in draft article 5 *(m)*.

64. The CHAIRMAN said that, since it was already clear that a netting agreement involved three or more parties, the addition would be simply for the avoidance of doubt.

65. Mr. ATWOOD (Australia) pointed out that the definition in draft article 5 *(m)* did not exclude an agreement between two parties only, since subparagraph (ii) referred to "a single payment by one party to the other".

66. Mr. COHEN (United States of America) said he wished to keep the definition as it stood. That definition was based on the comments by the European Banking Federation (A/CN.9/472/Add.1), which made no mention of three or more parties. The Commission had accepted the present definition for the purpose of excluding financial contracts based on netting agreements. The definition as it stood served the purpose of covering arrangements under different legal systems, some of which might provide for netting agreements between two parties only. If amended, it would not serve for the purpose of the exclusion.

67. Mr. DESCHAMPS (Observer for Canada) said it had been assumed during the Commission's discussions that it was not necessary for a contract to have more than two parties for it to qualify as a netting agreement. The definition of a netting agreement had been discussed in the context of agreements of the International Swaps and Derivatives Association, which normally involved only two parties.

68. The CHAIRMAN suggested that the additional text proposed by the representative of Germany should apply only to commercial receivables.

69. *It was so decided.*

70. Mr. SALINGER (Observer for Factors Chain International), commenting on the United States proposal (A/CN.9/XXXIII/CRP.8), said he welcomed the fact that draft article 11 would not apply to factoring agreements. However, factoring agreements did not always apply to financial services; they were sometimes entered into in order to collect debts and protect assignors against bad debts. He proposed that the commentary to the draft articles would state that agreements for factoring or the discounting of receivables would be regarded as financial services for that purpose.

71. The CHAIRMAN said he took it that the Commission wished to accept that proposal.

72. *It was so decided.*

73. The CHAIRMAN suggested that the proposed exclusion should apply to draft article 12 (3).

74. *It was so decided.*

75. Mr. MORÁN BOVIO (Spain) drew attention to paragraph 108 of the commentary (A/CN.9/470), where it was suggested that if the Commission included a rule on the form of assignment of a receivable, the rule would need to be aligned with article 12 (5). He wondered whether it was necessary to alter paragraph 5, since the formulation of the rule in article 8 was broad enough.

76. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) recalled the Commission's decision that the form of an assignment should be covered by a "safe harbour" rule stating that the assignment of a receivable was valid as to form if it met the form requirements, if any, of either the law of the State in which the assignor was located or any other law applicable by virtue of the rules of private international law. In the case of assignment of a receivable secured by a mortgage, the applicable rules of private international law as to form should be sufficient to refer the matter to the law of the land.

77. The Commission's additions to article 4 dealt with priority and with the acquisition of a property right in real estate as a result of the assignment of a receivable related to that real estate. The new rule adopted under article 8, on the other hand, stated that if there were any form requirements as to an assignment, it would be sufficient to satisfy the law of the assignor, except where the receivable was mortgage-secured. The matter might therefore have to be addressed in article 12 (5). in order to make it clear that the form of a mortgage-secured assignment was subject to the law of the land.

78. Mr. MORÁN BOVIO (Spain) suggested that one could either add an exception in article 12 (5) for real-estate-based receivables, which were to be governed by the law of the land, or simply add a cross-reference to the other relevant provisions of the draft Convention.

79. Mr. BAZINAS, noting that article 12 (5) preserved the law applicable outside the Convention with regard to the form of assignments, said that the simplest course might be to state there that neither the new provisions in article 8 regarding form nor article 12 (1) affected any requirements of the applicable law.

80. Mr. DESCHAMPS (Observer for Canada) observed that the "safe harbour" rule in article 8 applied to a receivable itself, but his delegation was not at all sure that it could apply to the required formalities allowing an assignee to exercise his rights in respect of any property securing the receivable, which, moreover, might be governed not by the law of the assignor's location but by that of another State.

81. Mr. STOUFFLET (France) said he agreed with Canada that the Secretary's proposal needed clarification. Article 12 (5) was essential and very clear as it stood. What was not clear was the relationship to the latest version of article 8 (2).

82. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) observed that under the new article 8 rule it was sufficient if an assignee met the form requirements of the law of the assignor's location, but that the question then arose as to whether that would be sufficient for the transfer of a security right securing the receivable in question. That matter could be settled either by an explanation in the commentary on article 12 (5) or by adding in paragraph 5 itself the explanatory statement he had previously suggested. Article 12 (5) could stand as it was, except for the possible need for clarification.

83. Mr. DESCHAMPS (Canada) said that the intent of the addition the Secretary of the Working Group had proposed was to clarify that article 12 (5) would not defeat the purpose of new article 8 (2), which dealt only with the formal requirements for the assignment of a receivable, while article 12 (5) itself dealt with the formal requirements for transfer of security rights. He saw no inconsistency between the two provisions and no need to change article 12 (5). If, however, the Commission decided to amend article 12 (5) to eliminate any ambiguity, care should be taken not to weaken the new rule in article 8. It must remain clear that an assignee's right in respect of the receivable, was effective as soon as the formal requirements of the law of the assignor's location were fulfilled, even if the formal requirements for the transfer of the security rights were not yet met.

84. Mr. STOUFFLET (France) said that perhaps article 12 (5) and article 8 (2) should be kept as they were, each with its own clear purpose.

The meeting rose at 6 p.m.

Summary record of the 694th Meeting

Friday, 23 June 2000, at 10 a.m.

[A/CN.9/SR.694]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.05 a.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/470, A/CN.9/XXXIII/CRP.2 and Add.1, CRP.8)

1. Ms. SABO (Observer for Canada) said she would prefer to delete article 4 (2) of the text contained in document A/CN.9/470, as the Commission could not be certain that States would only resort to it in very limited circumstances. Article 4 (2) could create disharmony to an extent that would outweigh the benefit of bringing in more States.

2. Mr. ATWOOD (Australia) said he agreed that article 4 (2) should be deleted, as it would increase the complexity of application of the Convention.

3. Mr. RENGER (Germany) noted that in view of the list of exclusions, the loophole of article 4 (2) was unnecessary. It would endanger the aim of achieving uniform law.

4. Mr. TELL (France) said he had previously shared Germany's views with regard to article 4 (2) because he had believed that the content of certain other provisions was already fixed. However, the Commission's discussions were resulting in changes to some of those articles, and he could not be certain of the content of the debtor protection—or consumer protection—provisions, which might not even be discussed at the current session. The Commission was trying to discuss a final clause before knowing the full contents of the Convention. His delegation might later find it necessary to refer to a particular type of debtor under article 39; he therefore suggested that the Commission should defer the debate on article 4 (2).

5. Mr. BURMAN (United States of America) said he agreed with the views expressed by the French delegation. Article 39 might yet be a critical safety valve for a number of countries. In order to ensure broad support for the draft Convention, there had to be the possibility of excluding certain highly organized industries that did not wish to be covered by its rules.

6. It was premature to discuss what was in effect a final provision that could be discussed only when the rest of the draft Convention had been agreed on.

7. Mr. FERRARI (Italy) said that the Commission should wait at least until the discussion of the debtor protection rules, which were referred to in both articles 4 (2) and 39.

8. The CHAIRMAN said he took it that the Commission would defer its discussion of article 4 (2) until it undertook its consideration of article 39.

9. Mr. COHEN (United States of America) said that, according to the Commission's preliminary report, the issue of dematerialized securities holdings, and even repurchase agreements, might still need to be addressed in the context of exclusions. On the previous day the Commission had heard from Mr. Potok, the International Bar Association's strong recommendation that the draft Convention should not cover assignments of receivables in investment securities. The existing exclusions did apply to part of that area, but they did not address the key issue of the holding of investment securities through intermediaries.

10. Mr. RENGER (Germany) agreed that the issue should be addressed.

11. Mr. COHEN (United States of America) proposed that the exclusion relating to assignments of receivables arising from the sale or loan of investment securities should be expanded to read: "This Convention does not apply to assignments of receivables arising from the sale, loan, agreement to repurchase, or direct or indirect holding of investment securities, whether or not dematerialized."

12. Mr. DESCHAMPS (Observer for Canada) agreed that the draft Convention should not apply to assignments of receivables arising from investment securities. However, the text should not be complicated unnecessarily. Article 4 (2) *(f)* of document A/CN.9/XXXIII/CRP.2 already excluded assignments of receivables arising under or from "The sale or loan of, or agreement to repurchase, investment securities". He considered that language to be sufficient to cover securities. In addition, the draft Convention applied only to assignments of receivables, and a receivable was defined as a right to payment of a sum of money. The right to obtain delivery of receivables was not a receivable.

13. Mr. DOYLE (Observer for Ireland) agreed with the previous speaker. He had no objection to the United States proposal, but did not see how it was different to the proposal contained in document A/CN.9/XXXIII/CRP.2. If it was not a policy issue, the Commission could accept the wording already offered by the drafting group.

14. Ms. GAVRILESCU (Romania) said she did not oppose the United States proposal but felt that the previous speakers would need to reach agreement on the wording.

15. Mr. SMITH (United States of America) said that the existing language did not cover his delegation's concerns, as it did not refer to the mere holding of securities, especially their holding in an investment account or securities account.

16. If his previous proposal had been too ambitious, the addition of the words "holding of investment securities" to subparagraph *(f)* would be acceptable.

17. The CHAIRMAN noted that the Canadian delegation's point had not been addressed. The "holding" of securities would not seem to generate any rights to payment, with the possible exception of fees earned by the intermediary.

18. Mr. SMITH (United States of America) said that there were many situations where the holding of securities and other financial assets in a securities account resulted in a receivable owed to the customer of that account. Cash balances in securities accounts

were not unlike deposit account cash balances, which were already excluded from the Convention. A broker could be obligated, when holding investment securities, to pay dividends received directly to the customer, or he could be obligated to sell securities which then created a receivable owed to the broker. The money then paid by the broker to the customer might also be a receivable. Rather than debating whether all of those rights to payment were receivables covered by the Convention, they could all be excluded by language specific enough to resolve any ambiguity.

19. Mr. STOUFFLET (France) said there was another unresolved substantive issue. The drafting group had had difficulty in interpreting a provision of the United States proposal relating to the scope of articles 11 and 12, which read in part as follows: "This article applies only to receivables: *(a)* Arising under an original contract for the sale or lease of goods". It was not clear what was meant by the word "goods", and whether subparagraph *(a)* in document A/CN.9/XXXIII/CRP.8 should also include a reference to receivables arising from the sale or lease of real estate.

20. Mr. DUCAROIR (Observer for the European Banking Federation) said he welcomed the United States proposal, which filled a gap in the Federation's proposal. It was not a question of transactions involving the sale or lease of real estate securities, which were dealt with by professionals in the financial market, but of the holding of real estate securities by individuals or institutional investors. The United States proposal was indispensable, because the person who placed real estate securities in a bank or in another financial intermediary had a receivable that required compensation. The dematerialization of real estate securities meant that they could be placed in an account, as opposed to being held in a tangible form. If the intermediary was in default, compensation in cash would have to be provided.

21. Mr. DESCHAMPS (Observer for Canada) said that his previous statement had been motivated by a concern to establish a text that would be accessible to outsiders, and therefore not unnecessarily complicated. The United States delegation had convinced him that it was appropriate to ensure that monetary receivables that might arise from holding an account with a broker or some other financial intermediary should be referred to.

22. Mr. MORÁN BOVIO (Spain) said he supported the proposed amendment for the reasons expressed by the previous speakers. He also expressed a reservation with regard to the list of exclusions. All members of the Commission should urgently consider the practices included in the list and determine whether they were the ones intended to be included, and whether they had sufficient coverage. Particular care should be taken to ensure coverage of all of the transactions that the Commission wished to exclude from the draft Convention. The Commission's methods of work needed to be clarified, for it was very difficult to deal with a text that was agreed on at one moment and was then almost immediately amended.

23. Mr. MARADIAGA (Honduras) said that his delegation agreed with the delegation of Spain. Since article 4 (2) referred to article 39, in which there were exclusions, it could not be considered in isolation without full knowledge of what would be excluded from the draft Convention; that would negate the objective of achieving legislative harmonization and unification.

24. Mr. RENGER (Germany) said that his delegation supported the United States proposal. It was obvious that the payment of interest or dividends generated by investment securities was a receivable, which arose through the direct or indirect holding of investment securities. The addition should therefore be made in order to have a complete understanding of what was excluded. There was no need for the words "whether or not dematerialized" because that was a technical aspect of securities trading.

25. Mr. TELL (France) said his delegation felt that it would be reasonable to exclude assignments of receivables arising from the holding of investment securities, if receivables arising from the sale or loan of investment securities were to be excluded. It was not necessary to specify whether the holding was direct or indirect, or whether or not the securities were dematerialized.

26. The CHAIRMAN said that the representative of France had summarized the direction in which the Commission seemed to be moving; the matter should be referred back to the drafting group. The representatives of Spain and Honduras had made the significant point that there must be clarity about exactly what was included in the draft Convention, and what was excluded. No surprises should be sprung after so many years of work.

27. Mr. TELL (France), referring to the Unites States proposal (A/CN.9/XXXIII/CRP.8), said that it was not clear whether the English word "goods" covered immovables.

28. Mr. MORÁN BOVIO (Spain) said that in Spanish, the word "*bienes*" could refer to movable or immovable goods.

29. The CHAIRMAN recalled that the Commission had conducted extensive deliberations on the question of excluding assignments of receivables arising from real estate transactions.

30. Mr. TELL (France) said that the word "*biens*" in French covered both movable and immovable goods. The problem was that the English word "goods" seemed to have a nuance which did not exist in other languages, and the Commission needed to know whether it covered immovable goods.

31. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that the Commission had considered an exception for rights arising from the sale or lease of real estate, and had decided that real estate should not be excluded. The question of whether the term "goods" included buildings had been raised in the drafting group but had been referred back to the Commission.

32. Ms. GAVRILESCU (Romania) said that her delegation fully agreed with the representative of France; in Romanian law, there was a clear distinction between movable and immovable goods. The English and French texts needed to be aligned.

33. Mr. FERRARI (Italy) said that the Commission should refer to other texts in which it had used the term "goods" and model the draft Convention on those texts.

34. Ms. McMILLAN (United Kingdom) said that land generally included buildings, but there was a distinction between goods and land, depending on the context.

35. Mr. DOYLE (Observer for Ireland) said his delegation agreed that the meaning of the term "goods" depended on the context. Goods would not include real estate, but real estate would include buildings. If there was any risk of ambiguity, the term "goods" could be defined in the text of the draft Convention.

36. Mr. SMITH (United States of America) said that it was his delegation's understanding that the Commission was talking not about buildings, but about goods in the narrow sense of personal property, rather than real property.

37. Ms. WALSH (Observer for Canada) said that her delegation believed that "goods" meant tangible movables or tangible personal property, and excluded real estate, including buildings.

38. Mr. STOUFFLET (France) said that there were two issues: whether receivables arising from real estate transactions were

covered by the draft Convention, and how those receivables would be treated under articles 11 and 12.

39. The CHAIRMAN said that those issues had been debated at length; apparently the language was still not satisfactory.

40. Mr. SALINGER (Observer for Factors Chain International) said he felt that the issue of whether "goods" constituted real estate depended on the situation. For example, bricks being delivered to a building site were goods, but once they had been put in place and mortared, they were real estate.

41. Mr. MORÁN BOVIO (Spain) said he believed that, as agreed in the previous week, the draft Convention covered all real estate transactions, except in cases where national law excluded such transactions. There was no reason to exclude real estate operations in articles 11 and 12; the interpretation of the word "goods" in articles 11 and 12 should therefore include immovables.

42. Mr. DOYLE (Observer for Ireland) urged the Commission not to reopen the debate on article 11, since it had accepted the text contained in document A/CN.9/XXXIII/CRP.8. The Commission had agreed to the text; all it needed to do now was to fine-tune the language.

43. Ms. WALSH (Observer for Canada) said that her delegation believed that "goods" meant tangible personal property and did not include personal property at large. She did not think that an assignment of a receivable relating to the lease of land was included under article 11 3*(a)*.

44. Mr. TELL (France) said that his delegation had always believed that the draft Convention applied to receivables arising from real estate operations. If the draft Convention did not cover real estate operations, there would be very little left.

45. The CHAIRMAN said that the issue was clear: one group of delegations believed that "goods" included real estate and would fall within the scope of the draft Convention; and the other group believed that "goods" did not include real estate and that real estate did not fall within the scope of the draft Convention.

46. Mr. COHEN (United States of America) said that his delegation was concerned that a question of translation could reopen a number of major policy decisions already made by the Commission. The issue of the scope of the draft Convention had been considered and resolved; it did not arise in article 11, but was dealt with elsewhere. It was his delegation's understanding that article 11 (3) applied to receivables arising from original contracts for the supply or lease of goods, but not for the lease of buildings.

47. Mr. TELL (France) said that the problem was that while the scope of application of the draft Convention as a whole was not defined in an inclusive manner, the United States proposal for article 11 (3) had the effect of defining positively the scope of application of articles 11 and 12, which could disrupt the system established so far. He saw no justification for excluding real estate transactions.

48. The CHAIRMAN recalled that the wording in document A/CN.9/XXXIII/CRP.8 had been designed to meet concerns about national laws governing land and receivables arising from the sale of land.

The meeting was suspended at 11.30 a.m. and resumed at 12.10 p.m.

49. The CHAIRMAN invited the Commission to resume its debate on whether receivables arising from an interest in real estate should be among the exclusions listed in article 11.

50. Mr. DOYLE (Observer for Ireland) said that first of all the Commission should settle its definition of "goods". He commended the suggestion by the representative of Italy that the word should be used as it was understood in international business practice and in other UNCITRAL conventions, particularly the United Nations Convention on Contracts for the International Sale of Goods, which had been ratified by 54 States, including France. No ambiguity had arisen over the use of the word "goods" in that document. It was, however, open to the Commission to provide a definition of the term.

51. Mr. HERRMANN (Secretary of the Commission) said that the difficulty of working in the six official languages of the United Nations was sometimes underestimated. A term natural to one language might carry a different implication in another. In the French version of document A/CN.9/XXXIII/CRP.8, the equivalent of the word "goods" was "*biens*", which included real estate and buildings. He could not deny that in the past delegations had on occasion used such language differences to reopen issues that had been settled; but that was all the more reason to welcome any attempt at clarification, even if it lengthened the proceedings. Ultimately, however, the Commission should decide its view on an issue and then find the appropriate way to express its policy.

52. Mr. TELL (France), after acknowledging the wisdom of the Secretary's comments, proposed an amendment in English, prepared with the help of the Canadian delegation, to the United States proposal contained in document A/CN.9/XXXIII/CRP.8. Subparagraph *(a)* should read: "Arising under an original contract for the supply or lease of goods or sale, lease or mortgage of real estate or the provision of services other than financial services."

53. Ms. WALSH (Observer for Canada) said that, owing to the confusion of the definition of "goods", the Commission had as yet reached no decision on the application of articles 11 and 12 to contracts relating to receivables arising out of immovable goods. Her delegation supported the expansion of the scope of the articles, as reflected in the French amendment, unless good reason was given why anti-assignment clauses should not be subject to the general rule under article 11.

54. Mr. COHEN (United States of America) said that his delegation was reluctant to lend its full support to the amendment proposed by the representative of France until it had had an opportunity to carry out consultations about its potential effect on the financing industry. Article 11 was a key provision of the draft Convention, on which consensus had been achieved only after much discussion. It had been recognized that the article need not apply to all assignments of all receivables because of the need not to upset well-established financing practices, in the field of real estate, among others. The proposed amendment undoubtedly gave article 11 a broader scope than his delegation had envisaged. He noted that the article did not mandate that anti-assignment clauses should be enforced. Domestic law could, therefore, override such a clause.

55. Mr. DOYLE (Observer for Ireland) said that the adoption of the proposed amendment would cause great difficulties for his delegation. The financing industry in Ireland was unwilling that real estate in any form should be covered by the draft Convention. His delegation had reluctantly agreed to the additional provision under article 4, but he had understood, on the basis of document A/CN.9/XXXIII/CRP.8, that article 11 would apply only to certain transactions relating to goods, not to real estate.

56. Mr. FRANKEN (Germany) expressed support for the proposed amendment. He saw no reason why receivables arising out of contracts relating to real estate should be excluded. Established practices need not be affected. Indeed, anti-assignment clauses were hardly ever encountered in contracts relating to real estate, in any case.

57. Ms. GAVRILESCU (Romania) expressed concern that the new provision created by the addition of the proposed amendment might cause confusion. There was no similar provision elsewhere in the draft Convention and she feared that the new provision which the Commission had recently adopted under article 4 might thereby be subject to a different interpretation from that intended. She was therefore in favour of leaving article 11 as it stood, particularly since the draft convention would, in principle, apply to all property except in those cases where it was overridden by domestic legislation.

58. Mr. TELL (France) said that there were no grounds for fearing that his proposed amendment would affect the exception contained in article 4. The amendment should, however, be passed on to the drafting group; he himself was not prepared to provide more than a rough translation of the English version.

59. Ms. McMILLAN (United Kingdom) said that the need to redraft provisions that had supposedly been finalized was an inevitable consequence of the Commission's decision to postpone consideration of the scope of the draft Convention to a very late stage.

60. She was prepared to accept the French proposal on the understanding that the assignment of receivables arising from land did not interfere with the internal legislation of the State where the land was located except insofar as that legislation was modified by the draft Convention itself.

61. She had serious reservations regarding the proposed amendment to article 4 (A/CN.9/XXXIII/CRP.2/Add.1); paragraph 3 *(a)* was unclear and paragraph 3 *(c)* was not an accurate representation of the outcome of the Commission's deliberations.

62. The CHAIRMAN said that the Commission would have to consider the entire report of the drafting group at a later date with such concerns in mind.

63. Mr. MORÁN BOVIO (Spain) said that he was in favour of the French proposal, since it provided the clarity that national industries would require in order to evaluate the draft Convention.

64. Mr. WINSHIP (United States of America) suggested that the text of the proposal should be placed in brackets and a decision on the matter postponed pending further consultations.

65. The CHAIRMAN noted that the Commission was meeting as a whole in order to finalize the provisions of the draft Convention. While he would defer to the wishes of the group, he did not think that there was broad support for postponing further discussion of the proposal.

66. Mr. IKEDA (Japan) noted that the word "goods" was translated as "*biens*" in the French text of document A/CN.9/XXXIII/CRP.8 but as "*marchandises*" in document A/CN.9/XXXIII/CRP.2/Add.1 (art. 11 (3) *(a)*). He also wondered whether the word "*hypothèques*" in the French proposal corresponded exactly to the English "mortgages". Lastly, if the Commission adopted the French proposal, the same amendment should be made to article 12.

67. The CHAIRMAN said that the Commission should concentrate on taking a clear policy decision; the drafting group would find the appropriate wording.

68. Mr. DESCHAMPS (Observer for Canada) suggested that further discussion of the matter should be postponed until the afternoon meeting so that the representatives of France and Canada could hold discussions with other participants in the interim. He was concerned that the mention of initial mortgage contracts might lead to the perhaps-inadvertent inclusion of a syndicated loan guaranteed by a mortgage. The Commission had already decided to preserve the clauses in syndicated loan contracts that made assignment subject to the consent of the borrower or the lead bank.

69. The CHAIRMAN asked whether the Commission wished to place the French proposal in brackets or to continue its efforts to find language that reflected the group consensus.

70. Mr. TELL (France) pointed out that on the previous day his own delegation had accepted language which it had earlier opposed but which had been approved by the Commission as a whole; it had not sought to place that text in brackets or to postpone the matter to a later date, and it would be equally inappropriate to do so in the case at hand.

71. The CHAIRMAN said that if he heard no objection, he would take it that the Commission wished to adopt the French proposal subject to drafting changes and to further consultations on the advisability of including a reference to mortgages.

72. *It was so decided.*

73. The CHAIRMAN invited the Commission to resume consideration of the report of the drafting group (A/CN.9/XXXIII/CRP.2/Add.1).

74. Ms. McMILLAN (United Kingdom) said that the proposed amendment to article 4 (3) *(a)* was quite incomprehensible from the point of view of British law. She took that provision to mean that the Convention did not affect any question as to whether an interest in land conferred a right in a receivable arising from a transaction related to that land. The words "interest in land" had a technical meaning, one illustration of which would be a freehold. But the question of how the fact of having a freehold interest in land could confer such a right—for example, in the case of a mortgage, how a freeholder could possibly have a right in the mortgage payments that he was obliged to pay to the mortgagee—would simply never arise. She wondered whether she had failed to grasp some essential aspect of the issue.

75. The proposed amendment to article 4 (3) *(c)* was similarly unclear.

76. Mr. DOYLE (Observer for Ireland) said that while he realized that the drafting group's task was a difficult one, the proposed amendment, and particularly paragraph (3) *(a)* thereof, bore little resemblance to the United States proposal on which it was based.

77. Mr. SMITH (United States of America) said he realized that translation was a difficult task and that some States' national legislation might not cover the issue addressed in the proposal.

78. The problem that his delegation had endeavoured to address in paragraph (3) *(a)* was that of a loan secured by a mortgage on real estate. In some countries, if that real estate was leased by its owner, the lease receivable was considered part of

the mortgage. Alternatively, crops grown on mortgaged land might give rise to a receivable which might be considered part of the mortgage under domestic law. The intent had been to ensure that such cases were determined according to the domestic law of the country in which the real estate was located.

79. The purpose of subparagraph *(b)* was to state that in cases such as those which he had described, conflicts of priority between the assignee of the receivable and the holder of the mortgage were not covered by the draft Convention.

80. The CHAIRMAN said that the wording of the proposal had apparently been an attempt to address an issue arising from the Commission's discussions. However, it was not for the drafting group to consider matters that had not actually been discussed by the Commission as a whole; such problems should be referred back to the Commission for further consultation.

ELECTION OF VICE-CHAIRMAN

81. Mr. CACHAPUZ de MEDEIROS (Brazil), speaking on behalf of the Latin American delegations, nominated Mr. Maradiaga (Honduras) for the office of Vice-Chairman.

82. *Mr. Maradiaga (Honduras) was elected Vice-Chairman by acclamation.*

The meeting rose at 1 p.m.

Summary record of the 695th Meeting

Friday, 23 June 2000, at 3 p.m.

[A/CN.9/SR.695]

Chairman: Mr. Jeffrey Chan (Singapore)

The meeting was called to order at 3.05 p.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-3; A/CN.9/XXXIII/CRP.2 and Add.1)

1. The CHAIRMAN invited the Commission to resume its consideration of the proposed text of article 4 [(3)] of the draft Convention (A/CN.9/XXXIII/CRP.2/Add.1), bearing in mind the concerns expressed by the United Kingdom.

2. Mr. MORÁN BOVIO (Spain) said he thought that subparagraph *(a)* stated the matter very clearly: the draft Convention did not affect rights conferred under national law in real estate or in a related receivable.

3. Mr. DESCHAMPS (Observer for Canada) said that the delegations of France, the United States and Canada agreed that subparagraph *(a)* need not refer to mortgages explicitly.

4. Mr. STOUFFLET (France) suggested that in subparagraph *(a)* the verb "is" should be replaced by the verb "includes", because a right in real estate comprised certain accessory rights.

5. Ms. WALSH (Observer for Canada) said that she too favoured use of the verb "includes" or "carries with it", as the Drafting Group preferred.

6. Mr. DOYLE (Observer for Ireland) said he supported the change if all agreed that that was what the Working Group had had in mind.

7. Ms. McMILLAN (United Kingdom) said that even if one used the verb "confers" the meaning was still not clear in terms of English land law.

8. Ms. WALSH (Observer for Canada) said that the matter was not explicitly addressed elsewhere in the draft Convention, but was bound up with the question of priority and had to be dealt with first, before the priority rule could be set out in subparagraph *(b)*.

9. The CHAIRMAN said he took it that the Commission wished to adopt the revised text of article 4 (3) as set out in document A/CN.9/XXXIII/CRP.2/Add.1, subject to drafting changes.

10. *It was so decided.*

11. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices), turning to chapter IV on rights, obligations and defences, reviewed the provisions of article 13 (1), (2) and (3). Paragraph 111 of the commentary (A/CN.9/470) indicated that the words ", unless otherwise agreed," in paragraph 2 might not be necessary. Paragraph 112 explained that no reference had been made to the subjective knowledge of the parties, as had been done in article 9 (2) of the United Nations Sales Convention, because of the effect on third parties. He also pointed out that the words "receivables financing" in paragraph 3 had been placed in square brackets until a final decision was reached on the title and preamble of the draft Convention.

12. Mr. MORÁN BOVIO (Spain) said that he favoured deleting the phrase "unless otherwise agreed" from article 13 (2), as suggested and retaining the text of article 13 (3) which covered the question very adequately.

13. Mr. SALINGER (Observer for Factors Chain International) said that in article 13 (2) the expression "bound ... by any practices" might lead to uncertainty if the expression "unless otherwise agreed" was deleted. It was quite normal in a factoring agreement to state that the agreement contained all matters agreed between the two parties to the exclusion of all else.

14. Mr. FERRARI (Italy), supported by Mr. DOYLE (Observer for Ireland), said that the text of article 13 (2) was fine as it stood and should not be changed. The point raised by Factors

Chain International would be taken care of because the provisions of its contracts would in any case override established practices, although as a rule those practices should prevail.

15. The CHAIRMAN said he took it that the Commission wished article 13 to remain as drafted, with the phrase in square brackets to be dealt with subsequently.

16. *It was so decided.*

17. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices), referring to article 14 concerning the representations made by the assignor at the time of the conclusion of the contract of assignment, said that the article had been formulated as a default rule because the Working Group had decided that paragraph 1 *(a)* should be read in conjunction with article 11, in which case, even if there was a contractual limitation on the assignment, the assignor still had the right to assign the receivable. Paragraph 1 *(c)*, denying any hidden defences or rights of set-off to the debtor, in essence provided that, in the absence of an agreement, the risk for hidden defences was borne by the assignor who, as contractual partner of the debtor, was in a better position to know whether the contract would be correctly implemented. The Working Group thought that such a rule would make credit less expensive than if the risk was borne by the assignee, where the higher cost would fall on the debtor and the assignor.

18. He drew attention to a number of questions, raised in paragraphs 115, 116, 119 and 120 of the commentary (A/CN.9/470), which would have to be decided by the Commission: whether a more explicit reference to representations regarding the existence of the receivable should be made in paragraph 1; whether paragraph 1 should include, in subparagraph *(b)*, a representation that there had been no previous assignments or other transfers by law; whether paragraph 1 should include a representation that the assignor would not modify the original contract without the consent of the assignee—a rule already to be found in article 22; whether paragraph 1 should include a representation that the assignor would transfer to the assignee any non-accessory right, something which article 12 had introduced as a matter of obligation; and whether it was within the scope of the draft Convention to address the consequences of a breach of representations for the effectiveness of an assignment, a matter which might have an impact in a case of insolvency.

19. Mr. MORÁN BOVIO (Spain), referring to the question raised in paragraph 115 of the commentary, said he believed that it was implicit in article 14 (1) *(a)* and *(b)* that the representations of the assignor extended to the existence, formal and substantive validity and enforceability of the receivable, although enforceability as it related to future receivables might create a difficulty under Spanish law. It might be useful to add to paragraph 1 the representations suggested in paragraph 119 of the commentary, although they were relatively implicit. The question of breach of representations referred to in paragraph 120, on the other hand, was not an implicit question and needed more thought.

20. Mr. DOYLE (Observer for Ireland) said he believed that article 14 (1) should be left as it was. The text was the result of extensive work in past years and the Working Group had taken decisions on difficult matters. He opposed referring to a breach of representations in the draft Convention.

21. Mr. MARADIAGA (Honduras) said that he saw no point in amending article 14 (1) *(a)*.

22. The CHAIRMAN said he took it that article 14 could remain as drafted.

23. *It was so decided.*

24. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that article 15 (1) ensured that the assignee could send the debtor a notification of the assignment and the payment instruction independently of the assignor, since the assignee's interest in having the notification sent might be at stake if there was inadequate cooperation between the assignor and the assignee; but that after notification, only the assignee might send a payment instruction.

25. Article 15 (2) stipulated that a notification of the assignment or payment instruction was sufficient for the purposes of article 19 to trigger the manner in which the debtor discharged the payment obligation, even though the notification or instruction might have been in breach of an agreement between the assignor and the assignee. That implied that such notification or instruction would not have an effect on the debtor's rights of set-off against the assignee—although, under article 20, the debtor could not raise against the assignee any right of set-off not available to the debtor at the time of notification—and would also in no way limit the debtor's right to modify the original contract in agreement with the assignor without the consent of the assignee. The second sentence of paragraph 2 was intended to preserve the liability of the party in breach of the agreement between the assignor and assignee, which liability might fall under law that was outside the draft Convention. It would be noted that article 15 cast notification as a right between the assignee and the assignor and not as an obligation.

26. The CHAIRMAN said that he took it the Commission wished article 15 to remain as drafted.

27. *It was so decided.*

28. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that article 16 again elucidated a relationship between the assignor and the assignee, namely, the right to payment. It stated explicitly what had been implicit in articles 2 and 9: as between the assignor and the assignee, the assignee had a proprietary right in the assigned receivable and any proceeds. Paragraph 1 set out the three possibilities—payment in respect of the assigned receivable to the assignee, the assignor or a third person over whom the assignee had priority—and stipulated in each case the assignee's right to payment. Paragraph 2 established that the assignee could not retain more than the value of its right in the receivable—a provision that was particularly useful in cases of assignment by way of security, where the price of the receivable exceeded the price owed to the assignee.

29. He recalled that, in the discussion on article 6, a question had been raised as to whether returned goods should be included in the definition of proceeds, and the issue had been deferred until the discussion of articles which dealt with proceeds. Since article 16 was the first such article, the Commission might wish to revert to that question.

30. Mr. MORÁN BOVIO (Spain) said that there was no need to change the definition of proceeds in article 6. He saw no problem with the current formulation of article 16, which mentioned "returned goods" along with "proceeds" where applicable.

31. Ms. WALSH (Observer for Canada) said that returned goods did not naturally come within the concept of proceeds and that the reference in article 6 *(k)* was ambiguous at best, since it provided no definition of returned goods. In article 16 (1) *(c)*, proceeds were clearly distinct from returned goods. Since that clause was perfectly clear, there was no need to refer to returned

goods a second time in article 6 *(k)*. The last sentence of article 6 *(k)* should therefore be deleted. While a definition of proceeds might be necessary for the purposes of article 24, it was not necessary for the purposes of article 16.

32. Mr. SALINGER (Observer for Factors Chain International) said that, if returned goods were not proceeds, then the draft Convention should not suggest that they were proceeds. He was satisfied with the existing wording of article 16, although it provided only that the assignee had a right to proceeds vis-à-vis the assignor. When the Commission took up article 24, it should consider the case of an assignee who received returned goods, not as proceeds, but in substitution of a cancelled receivable. Priorities in that respect should be clearly defined according to a rule of private international law.

33. Mr. DOYLE (Observer for Ireland) said he agreed that the current wording of article 16 presented no difficulties with respect to the definition of proceeds. The question mentioned by the preceding speaker should be taken up in the discussion of article 24.

34. The CHAIRMAN said he took it that the Commission wished to leave article 16 unchanged but to bear in mind the points raised when it discussed article 24.

35. *It was so decided.*

36. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that article 17 was intended to address the need for debtor protection. The general principle underlying it was that an assignment did not change the legal position of the debtor without the latter's consent and unless otherwise explicitly provided in the draft Convention, and that any doubt as to whether the draft Convention affected the legal position of the debtor should be resolved in favour of the debtor. Paragraph 2 of the article provided that, whatever change was effected in the debtor's legal position as a result of an assignment, the country or currency of payment could not be changed. Paragraph 2 *(b)* provided that the country of payment could not be changed except to the country in which the debtor was located, but paragraph 129 of the commentary suggested that even that change should be made subject to the consent of the debtor.

37. Mr. MORÁN BOVIO (Spain) said that the suggestion contained in paragraph 129 of the commentary was interesting and should be reflected in the text of article 17 through the insertion of the words "unless the debtor so consents" at the end of paragraph 2 *(b)*.

38. Mr. TELL (France) recalled that his Government had submitted a number of comments on the draft Convention, which were contained in document A/CN.9/472. Since the Working Group had decided that assignments to consumers were not excluded from the scope of the draft Convention, the latter must not affect the legal position of consumers. Article 17 provided that the debtor could agree to waive rights contained in the original contract, yet French law provided that consumers, as debtors protected by law, could not accept renunciation by contract of provisions reflecting public policy. In view of the last sentence of paragraph 128 of the commentary on article 17, he did not understand why that article did not contain a reservation with respect to the implementation of consumer protection laws, as did articles 21 and 23. A new article, based on the language contained in article 21 (1), should be inserted at the beginning of chapter IV, section II, specifying that articles 17 to 23 were without prejudice to the law governing the protection of the debtor in transactions made for personal, family or household purposes in the State in which the debtor was located.

39. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) pointed out that the issue of consumer protection was addressed in a number of articles in chapter IV, section II. For example, article 19 (6) allowed debtors to discharge their obligations under laws outside the draft Convention; article 20 preserved all the debtor's defences and rights of set-off arising from the original contract and from any related transactions, excluding only set-offs that had not been available to the debtor at the time of notification; article 21 (1) referred explicitly to consumer protection legislation; article 22 provided for a limitation only as to the modification of the original contract after notification of the assignment; and article 23 explicitly made the recovery of payments subject to consumer protection legislation. The Working Group had taken the view that specific concerns about debtors as consumers should be addressed in the relevant provisions of the draft Convention.

40. Mr. FRANKEN (Germany) said that he agreed with the representative of Spain that a reference to the consent of the debtor should be included in article 17 (2) *(b)*.

41. Mr. BRINK (European Federation of National Factoring Associations (EUROPAFACTORING)) said that the basic idea of article 17 was to protect debtors against unjust alterations in the original contract. In practice, factors sometimes had the opportunity to employ another factor located in the same country as the debtor, whereas the parties to the original contract had been located in different countries. In those circumstances, the Working Group had considered it useful to allow the debtor to pay the assignee in the country in which both were located, rather than forcing the debtor to make international transfers. The article should be left as it stood, since he saw no reason to change it to accommodate the very few debtors who might have an interest in sending their payments to the country in which the assignor was located. The draft Convention could not be expected to cover every minute detail of every transaction in the global economy; it was intended only to provide, in as few words as possible, practical solutions to cover most of the transactions currently carried out.

42. Mr. SALINGER (Observer for Factors Chain International) said that he shared the views of the preceding speaker. Since the establishment of the Factors Chain International system in 1964, vast quantities of goods had flowed between countries and the receivables arising therefrom had been assigned to factors in the countries of both exporters and importers, to the benefit of both. He did not know of a single case in which a debtor had objected to that arrangement, whereby it was able to make payment in its own country. The text should not be changed, since changes might cause difficulties for a system that had operated successfully for many years.

43. Ms. McMILLAN (United Kingdom) said that she shared the views of the preceding two speakers.

44. Mr. WINSHIP (United States of America) said that he saw no reason why debtors should be allowed to consent to a change in the country of payment but not to a change in the currency of payment. The indication "unless the debtor otherwise consents" should therefore apply to both 2 *(a)* and 2 *(b)*, since there was no difference in the public policy reflected by those two clauses. Another problem concerned the fact that article 6 (formerly article 7) of the draft Convention did not expressly provide for party autonomy with respect to agreements between the assignee and the debtor. As a result, the words "may not" in article 17 (2) could be interpreted as excluding the possibility of party autonomy.

45. Mr. FRANKEN (Germany) said that he did not see why provisions to protect the debtor should cause difficulties for the factoring industry. Paragraph 2 should indicate that the debtor's consent was required in respect of both clauses *(a)* and *(b)*. He supported the position of the United States delegation.

46. Ms. WALSH (Observer for Canada) recalled that, under article 9, assignments of parts of receivables to more than one assignee were effective. However, article 9 did not indicate whether such assignments were effective against debtors. It could be argued, under article 17 (1), that since assignments did not affect the payment terms contained in the original contract, notifications or payment instructions from several assignees, each claiming part of a receivable, would not be effective. However, the current wording of the draft Convention was ambiguous. The Commission must decide on a policy in that regard.

47. Mr. DOYLE (Observer for Ireland) said that the current wording of article 17 (2) should be retained, since the proposed change was of concern to the representatives of the factoring industry.

48. Mr. SALINGER (Observer for Factors Chain International) said, in response to the German delegation's statement that the adoption of the suggestion in paragraph 129 of the commentary should not cause problems for factors, that the purpose of the draft Convention was to make credit more widely available and less expensive. However, dealing with debtor consent in a very large number of relatively small transactions would be an administrative nightmare and would not encourage the provision of financial services to assist the movement of goods and services between countries.

49. Mr. TELL (France) said that party autonomy was not a reality for the consumer, who had little or no power to dictate the terms of a contract. For that reason, many national laws and European Union directives protected the consumer-debtor against unfair clauses, particularly waivers of rights and defences, by declaring them void. Although a general exception applicable to all of chapter IV, section II, might not be warranted, at least the "without prejudice" clause of article 21 could be repeated at the beginning of article 17.

50. Ms. MANGKLATANAKUL (Thailand) said that, even though the draft Convention provided for consumer protection in specific articles, for the sake of the interpretation and application of the Convention, there should be a general statement on the need to protect consumers.

51. Mr. FRANKEN (Germany) and Ms. LADOVÁ (Observer for the Czech Republic) said that they agreed with the French proposal for a "without prejudice" clause at the beginning of article 17.

52. Mr. WINSHIP (United States of America) said that his delegation doubted the wisdom of introducing a general clause on consumer protection. The Working Group had considered the issue and decided against it. The draft Convention already contained specific rules allowing mandatory consumer protection legislation to prevail in specific contexts. The most important reason, however, was that such a clause might work to the disadvantage of consumers. One of the aims of the draft Convention was to facilitate bulk assignments of consumer receivables in order to lower the cost of credit to consumers. If the consent of each credit card holder was required in order to securitize credit card debt, such transactions would be nearly impossible.

The meeting was suspended at 4.35 p.m. and resumed at 5.10 p.m.

53. The CHAIRMAN said that, as he understood it, the representative of France had proposed that the language on consumer protection should be removed from article 21 and other articles where it appeared and should be set out as a general principle. From a show of hands, he gathered that a large number of delegations (Australia, Austria, Cameroon, Islamic Republic of Iran, Italy, Spain, United States of America and the observers for Canada and Ireland) wished the text of article 17 to remain as it stood.

54. Mr. TELL (France) said that the concerns of his delegation focused on the consent of the debtor mentioned in article 17(1). Under European Union directives as well as French national legislation, the consumer could not effectively give such consent. There was also some difficulty with national legislation that prohibited the displacement of the consumer's obligation to pay from the assignor to the assignee, but that was a minor problem compared with the conflict with Community treaty obligations involving the consent issue.

55. After consultations during the suspension, he could understand the reasons why some delegations felt that language like that at the beginning of article 21 might be misinterpreted and undermine the effectiveness of article 17. As a compromise, he therefore proposed a new paragraph stating that the consent of the debtor mentioned in paragraph 1 was without prejudice to law governing the protection of the debtor.

56. In practice, the courts of the debtor's location would in any case apply consumer protection laws as a matter of public policy, in keeping with article 25 of the draft Convention, so that the consent of the consumer-debtor given in the context of article 17 would be ineffective in any case. The new paragraph would not affect the application of article 17 to commercial debtors.

57. Mr. RENGER (Germany) said that his delegation supported the French proposal.

58. Mr. SMITH (United States of America) said that the point, as his delegation understood it, was that, where the principle of party autonomy was overridden by consumer protection legislation in the debtor's jurisdiction, the draft Convention should respect that legislation. He would propose an alternative version of the new paragraph, which would read:

> "The Convention should not permit, in a consumer transaction, the consumer-debtor to vary or derogate from the original contract if that is not permitted under the consumer protection law of the debtor's location."

59. Mr. DOYLE (Observer for Ireland) said he doubted whether there was a consensus for making a fundamental change to the text at such a late date. Consumer protection was not a new issue and had been debated long and hard by the Commission over several sessions and by the Working Group. His delegation favoured keeping the text of article 17 as it stood.

60. Mr. FERRARI (Italy) said that his delegation did not believe the international public policy approach raised by the representative of France would work well in article 17, which was a substantive law provision. The text should remain as it stood.

61. Ms. GAVRILESCU (Romania) said that her delegation supported the French proposal in principle but would like to know whether the representative of France agreed with the United States amendment.

62. Mr. KUHN (Observer for Switzerland) said that, although reluctant to change the text as it stood, his delegation could support the United States proposal, which appeared to capture the thrust of the point raised by France and address the concerns of a number of delegations.

63. Mr. MARADIAGA (Honduras) and Mr. IKEDA (Japan) did not see sufficient reason for changing the text of article 17.

64. The CHAIRMAN said that there appeared to be support both for the French proposal and for leaving the text as it stood. Since, at the present stage of deliberations, the principle to be followed was that the text agreed upon by the Working Group should not be changed unless there was consensus in favour of amendment, the proposal could not be adopted.

65. Mr. HERRMANN (Secretary of the Commission) said that, since work on the draft Convention would obviously not be completed during the present session, the Commission should consider two questions regarding its future work on the topic. First, it should decide whether to hold a session of the Working Group on International Contract Practices, or perhaps an ad hoc working group, prior to the next session of the Commission. Second, assuming that work on the draft Convention would be completed at the next session, the Commission should consider whether to submit the draft to the General Assembly or to a diplomatic conference, held either at Commission headquarters or in another State upon invitation.

66. The CHAIRMAN asked the Commission to bear in mind that if the draft Convention was referred to its next session in 2001, no progress would be made for a whole year. Moreover, very specific terms of reference would be required if the text was to be sent back to the Working Group, since the latter had already finished its work on the draft articles. As for the report of the Drafting Group, it must be considered by the Commission itself; it could not be sent directly to the Working Group.

67. Mr. BURMAN (United States of America) said there was no procedural impediment to remitting the text to the Working Group, nor would it be a sign of failure to do so. The Working Group could begin again where the Commission had left off, and it could proceed to deal with the text on the basis of the same terms of reference as before. It should preserve the language already adopted by either the Commission or the Working Group, in the absence of objection by any member State. That would enable the text to be finalized by the Commission at its next session, on the basis of a set of recommendations produced by the Working Group in December 2000. The Commission would then be in a position to submit the draft Convention to the Sixth Committee of the General Assembly, which could decide to hold a diplomatic conference to adopt it, if a country offered to host such a conference. He thought a resolution could be formulated to enable the Commission to proceed with the work on its product by either method.

68. The CHAIRMAN asked what was meant by the term "product". He pointed out that in the United Nations, when texts were sent back to a working group it was normally at a point when the major organ concerned had considered a text and had decided that more work was needed on it. If the Commission now decided to remit the draft articles to the Working Group, it would be sending back text on which the Working Group had already completed its work. Another factor to be considered was the question of cost.

69. Mr. BURMAN (United States of America) explained that he had used the term "product" because of the likelihood that the Commission's work would ultimately include a commentary as well as a set of draft articles.

70. Mr. MORÁN BOVIO (Spain) was in favour of sending the draft articles back to the Working Group, because a number of issues still had to be resolved. Given stricter terms of reference, the Working Group could virtually complete work on the draft articles by December 2000. As for the method of adopting the draft Convention, his delegation would prefer a diplomatic conference if there was a country willing to bear the extra cost, because the draft Convention was expected to have a significant impact, even in the developed countries. A diplomatic conference would be a means of securing an appropriate degree of publicity for the new instrument.

71. Mr. HERRMANN (Secretary of the Commission) explained that if a diplomatic conference took place in Vienna, the seat of the Commission, the cost would be in the region of US$ 2 million and would be borne by the United Nations. If such a conference was held in a host country, that country would have to bear any additional cost, which he would estimate at approximately half a million United States dollars.

72. Mr. RENGER (Germany) felt that the Working Group could not do much more work than it had already done on the draft articles, whatever terms of reference it might be given. The Commission had identified several outstanding issues, such as the question of location in chapter V, which the Working Group had been unable to resolve and which must be settled by the Commission itself. The Commission could not yet make a decision to convene a diplomatic conference, since it had not completed its work on the draft Convention. Moreover, it was evident from the comments by Governments on the draft Convention that the time was not yet ripe for convening a diplomatic conference.

73. Ms. SABO (Observer for Canada) hoped that the Commission would demonstrate its flexibility by enabling the Working Group to continue work on the draft articles. The Group's terms of reference could be very simple, requiring it merely to proceed with the draft articles not yet reviewed by the Commission, in the light of the changes already made. There could then be another round of comments by Governments, after which the Commission could review the completed text at its next session. She supported the suggestion by the representative of the United States that the Commission should formulate a recommendation to the General Assembly which would enable the Sixth Committee to decide whether a diplomatic conference would be the appropriate forum for adopting the draft Convention.

74. Mr. TELL (France) observed that the Commission had now introduced many changes into the text produced by the Working Group, which bore little comparison to the draft articles in their present state. Moreover, there were still important issues to be resolved, such as those concerning location and branch offices. There was also the question of consumer protection. The Working Group had not been able to tackle that question, partly for political reasons; but if the future Convention was to win wide acceptance within the European Union, a change of mind would be necessary on the part of States which did not have advanced legislation on consumer protection. It would be also be difficult for the Working Group to proceed with a text in which all the draft articles were interdependent; account had to be taken of the impact of the changes the Commission had made to some draft articles at its current session. His delegation therefore preferred that the Commission should resume consideration of the draft Convention as a whole at its next session. As for the method of final adoption of the draft Convention, a decision at the present juncture would be premature, and should be made by the Commission at its next session.

The meeting rose at 6.05 p.m.

Summary record of the 696th Meeting

Monday, 26 June 2000, at 10 a.m.

[A/CN.9/SR.696]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.05 a.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.2 and Add.1-2)

1. The CHAIRMAN recalled that at the previous meeting the Commission had taken up the issues of whether to refer the draft Convention back to the Working Group, and whether to recommend to the General Assembly that the draft Convention should be adopted at a diplomatic conference, or by the Assembly itself. The Commission had now received the rest of the report of the drafting group (A/CN.9/XXXIII/CRP.2 and Add.1-2), which it would need to consider.

2. Mr. BURMAN (United States of America) said his delegation recommended that the Commission should continue its efforts to resolve outstanding issues in relation to the draft Convention before taking up the drafting group's report.

3. Mr. ATWOOD (Australia) said it was disappointing that the Commission had been unable to complete its consideration of the draft Convention. If the draft text was referred back to the Working Group, the task of that Group should be clearly defined. As to the question of whether the draft Convention should be adopted by the General Assembly or at a diplomatic conference, his delegation believed that the Commission should make an open-ended recommendation to the General Assembly, leaving open the possibility of the draft Convention being adopted by either process.

4. Ms. MANGKLATANAKUL (Thailand) said that her delegation was in favour of referring the draft Convention to the Working Group. Many new issues had been raised which needed to be re-evaluated. Her delegation hoped that the draft Convention would be adopted at a diplomatic conference, depending on the financial possibilities.

5. Ms. McMILLAN (United Kingdom) said that her delegation associated itself with the two previous speakers. The Working Group's task and terms of reference must be clearly defined.

6. Mr. PANG (Singapore) said his delegation felt that any further consideration of the draft Convention should be carried out by the Commission, since the Working Group had already completed its work. Sending back the draft Convention to the Working Group would enable the latter to reopen issues which had already been settled, no matter what its terms of reference. Moreover, the Commission's resources would be put to better use if it considered the draft Convention directly.

7. Mr. BURMAN (United States of America) said that there seemed to be considerable support for sending the draft Convention back to the Working Group. The Working Group had not actually completed its consideration of the text, and a number of issues had been left unresolved. There would be an understanding that issues which had already been resolved would not be reopened. His delegation supported the idea that the Commission should send a draft resolution to the Sixth Committee on the adoption of the draft Convention either by the General Assembly, in 2001, or, if a host country had been secured and there were assurances that the costs would be contained within existing budgetary resources, at a diplomatic conference.

8. Mr. HERRMANN (Secretary of the Commission) said that if the draft Convention was adopted at a diplomatic conference, it was unlikely that the host State would cover all the costs; the tradition had been that the host State would pay the difference arising from the fact that the conference was not taking place at the location of the substantive secretariat. It was difficult to make an estimate of the costs, which would depend partly on the extent to which modern technologies could be used. The Commission should draw up a draft resolution so that that internal process could be started and the possibility of holding a diplomatic conference could be taken into account when the next programme budget was drawn up.

9. Ms. STRAGANZ (Austria) said that her delegation was in favour of referring the draft Convention to the Working Group, and of formulating an open-ended draft resolution on the adoption of the draft Convention.

10. Mr. MOHAMED (Nigeria) said that his delegation would prefer the draft Convention to be finalized in the Commission, rather than the Working Group. It was premature to take up the question of a diplomatic conference, before completing work on the draft Convention.

11. Mr. HERRMANN (Secretary of the Commission) said that the Working Group could meet in December 2000. However, if the Commission wished to continue its consideration of the draft Convention it would have to do so in January 2001, since it had exhausted its entitlements for 2000.

12. Mr. GHAZIZADEH (Islamic Republic of Iran) said that his delegation was in favour of sending the draft Convention back to the Working Group, so as to avoid delays in finalizing the draft Convention. His delegation supported the idea of holding a diplomatic conference for the adoption of the draft Convention.

13. Ms. GAVRILESCU (Romania) said that her delegation could go along with any decision which was supported by the majority of members of the Commission. However, it would be preferable not to send the draft Convention back to the Working Group, because the latter had referred some unresolved issues to the Commission, which had not yet resolved them. She also had reservations about making a recommendation about the adoption of the draft Convention because the text had not been finalized.

14. Mr. DOYLE (Observer for Ireland) said that the Working Group, although it had done all it could, had clearly not completed its work; if it had, the Commission would not have spent two weeks discussing the scope of the draft Convention. Much remained to be done. Indeed, another session might not suffice for the Commission to finalize a text. He was therefore in favour of referring the matter to the Working Group, obviously with

strict terms of reference. He saw no insuperable difficulty in circulating the Working Group's report. On the question of a diplomatic conference he urged flexibility.

15. Mr. MARADIAGA (Honduras) said that ideally the Working Group should reconsider the draft text and return it to the Commission. Progress had been so slow, however, that his preference would be to allow the secretariat to make the decision, on the basis of circumstances as they unfolded. The option of holding extra meetings was impracticable, owing to the shortage of resources.

16. Mr. MORÁN BOVIO (Spain) said he was in favour of returning the draft text to the Working Group: the impact of the Commission's deliberations had been such that the whole conformation of the draft Convention had changed. He trusted that at its next session the Commission would be able to review the Working Group's work faster than at the current session.

17. Mr. TELL (France) said that, given the shortage of available time and the fact that the Commission would in any case have to scrutinize any draft text, it would be better for the Commission to assume the work itself. Moreover, discussion of article 18 onwards, on which substantive decisions would need to be taken, would inevitably lead the Working Group to reopen issues that had already been settled.

18. Mr. AL-NASSER (Observer for Saudi Arabia) favoured returning the text to the Working Group, many of whose members also participated in the Commission. The Working Group could submit a text in which all the problems raised during the current session could be resolved.

19. Mr. RENGER (Germany) concurred with the view of the representative of the United Kingdom that if the draft text was to be returned to the Working Group—to which he had no objection—clear terms of reference must be laid out. Future action should be dictated by circumstances. As for adoption, the Commission might benefit from the discipline imposed by a timetable: a final text might be ready for adoption under a General Assembly resolution by 2001, whereas practical considerations suggested that a diplomatic conference could not be convened before 2002.

20. Ms. SABO (Observer for Canada) said that, following informal consultations with others, her delegation was firmly persuaded that the text would be best finalized by the Working Group. Some of the hardest decisions had already been taken and little time was available, since there was much else of importance to discuss. The Working Group would also produce a coherent text on which States could make comments.

21. Mr. IKEDA (Japan) said that the majority was clearly in favour of returning the draft text to the Working Group. As a member of the Group, he believed it capable of solving the outstanding problems and submitting a complete draft text to the Commission.

The meeting was suspended at 11.20 a.m. and resumed at 11.50 a.m.

Title of the draft Convention

22. The CHAIRMAN invited the Commission to resume consideration of the report of the drafting group (A/CN.9/XXXIII/CRP.2) and, in particular, to take a decision on the title of the draft Convention.

23. Mr. WINSHIP (United States of America) said that his delegation would have preferred the title "Draft Convention on the Assignment of Receivables"; however, there appeared to be a clear consensus in favour of "Draft Convention on Assignment of Receivables in International Trade".

24. Mr. MORÁN BOVIO (Spain), Mr. MARADIAGA (Honduras) and Mr. RENGER (Germany) said that their delegations joined that consensus.

25. Mr. MARKUS (Observer for Switzerland) said that he would prefer the title "Draft Convention on the Assignment of Receivables" since the inclusion of a reference to international trade might restrict the scope of the instrument, which covered not only trade, but also financial, receivables. However, he was prepared to join the emerging consensus.

26. Mr. LAMBERTZ (Observer for Sweden) said that he associated himself with the views expressed by the observer for Switzerland.

27. Mr. MORÁN BOVIO (Spain) pointed out that since the titles of the Commission's instruments almost always included a reference to international trade, those words should in no way be taken as limiting the scope of the draft Convention.

28. Mr. TELL (France) said that he would prefer to mention international trade in the title in order to make it clear that the draft Convention was not intended to cover the assignment of receivables at the domestic level.

29. Mr. IKEDA (Japan) said that he agreed with the representative of France.

30. Mr. MARADIAGA (Honduras) said that if a shorter title was desired, the instrument might be called "Draft Convention on International Assignment of Receivables".

31. Mr. MOHAMED (Nigeria) supported the inclusion of the words "international trade"; the concerns raised by the observers for Switzerland and Sweden could be addressed in the commentary.

32. The CHAIRMAN said that if he heard no objection, he would take it that the Commission had reached consensus on the title "Draft Convention on Assignment of Receivables in International Trade".

33. *It was so decided.*

Preamble (A/CN.9/470)

34. The CHAIRMAN invited the Commission to take a decision on the bracketed text contained in the preamble to the draft Convention (A/CN.9/470).

35. Mr. MORÁN BOVIO (Spain) said that in several cases, the question of which bracketed option to retain could be assumed to have been resolved by the Commission's decision on the title of the draft Convention.

36. Mr. RENGER (Germany) said that he would prefer to delete the bracketed words "that", "the" and "constitute an obstacle to financing transactions" from the second preambular paragraph.

37. Mr. IKEDA (Japan) said that his delegation was in favour of retaining the reference to financing transactions, the promotion of which was the primary objective of the draft Convention.

38. Mr. TELL (France) said he agreed that the instrument's purpose would be lost if the words "constitute an obstacle to financing transactions" were deleted; it must be clear that the draft Convention was intended to facilitate receivables financing rather than simply resolving conflicts between different national legal systems. He would therefore prefer to retain all the words currently placed in brackets in the second preambular paragraph.

39. Mr. MORÁN BOVIO (Spain) suggested that the Commission should adopt the German proposal to delete all the bracketed material in that paragraph except the words "of receivables" and to address those issues in the commentary. However, he was prepared to defer to the majority view.

40. Ms. SABO (Observer for Canada) said that the Working Group had discussed the matter at length. Her preference would be to delete all the material contained in brackets in the second preambular paragraph; however, as a compromise, she proposed that the bracketed text should be retained and the words "in international trade" deleted.

41. The CHAIRMAN pointed out that the Canadian proposal did not address the question of whether the Commission wished to include an explicit reference to financing.

42. Mr. PINZÓN SÁNCHEZ (Colombia) said that since the Commission had decided not to mention receivables financing in the title of the draft Convention, it might be best to delete the second preambular paragraph and to consider whether the subject of financing should be covered in the third and fifth preambular paragraphs.

43. Mr. WINSHIP (United States of America) said that his delegation associated itself with the statements made by the representatives of Japan and France and supported the amendment proposed by the observer for Canada. The fact that the problems mentioned in the first line of the paragraph constituted an obstacle to financing transactions was one of the chief reasons for the need to adopt the uniform rules referred to in the fifth preambular paragraph.

44. Moreover, the decision to refer to the preamble in article 7 (1) gave it an importance that should be explicit in the text of the draft Convention, particularly as the form and status of the commentary had yet to be determined.

45. Mr. DOYLE (Observer for Ireland) said he agreed that the preamble was more important than might first appear and that he would prefer to retain the bracketed text in the second preambular paragraph: however, he had no strong feelings on the matter.

46. Ms. McMILLAN (United Kingdom) said she would not wish to lose the paragraph as a whole, as it expressed part of the reason for the Convention. Her delegation supported retention of the paragraph, as reworded by Canada.

47. Mr. MARADIAGA (Honduras) suggested that the secretariat should take care of some of the drafting. As the Commission had decided to use the wording "assignment of receivables in international trade" in the title of the Convention, the bracketed expressions in the preamble referring to "financing" were no longer required.

48. Mr. RENGER (Germany), Mr. MORÁN BOVIO (Spain) and Ms. STRAGANZ (Austria) said they supported the new wording.

49. The CHAIRMAN said he took it that the second preambular paragraph would be reworded as suggested by the Canadian delegation.

50. Mr. WINSHIP (United States of America) suggested that the words "receivables financing" and "financing" should be deleted in the third preambular paragraph. However the clause beginning "including but not limited to." should be retained in order to alert the reader as to the types of transactions covered by the draft Convention. The list might not be complete, but the illustrations given stressed the importance of the text and the wide variety of transactions.

51. Mr. MORÁN BOVIO (Spain) and Mr. TELL (France) said they shared the views expressed by the United States delegation.

52. Mr. TELL (France) noted that, in view of the change in article 11 made the previous week, the text did not in fact protect "existing assignment practices".

53. Ms. WALSH (Observer for Canada) agreed with the proposal to delete the reference to "receivables financing" and "financing" in the third paragraph. However, she was concerned that the illustrative list did not refer to the very important use of assignment transactions in providing collateral for loan financing. Also, the list could be under-inclusive, become dated over time and give rise to unnecessary interpretation difficulties. It would be simpler to delete the list rather than to discuss what should be included.

54. Ms. GAVRILESCU (Romania) said she shared the views expressed by the United States delegation but also agreed with the concerns of the Canadian delegation. Perhaps there could be a compromise solution, as the list did not exclude other possibilities.

55. Mr. DOYLE (Observer for Ireland) said he shared the concerns of the Canadian delegation and was also in favour of deleting the list.

56. Ms. McMILLAN (United Kingdom) said she was also in favour of deleting the list. There was already a list of exclusions in article 4, as well as the list of inclusions in articles 11 and 12. The difficulty of having an additional list in the preamble was that it might seem to conflict with the later text.

57. The CHAIRMAN noted that the United States delegation had mentioned on a previous occasion that inclusion of the list would give a signal to those industries to which it referred.

58. Mr. RENGER (Germany) agreed with the views expressed by the United Kingdom delegation. Also, he doubted whether the industries referred to would actually read the preamble.

59. The CHAIRMAN said he took it that the Commission accepted the paragraph, with the deletion of the list and the deletions suggested by the United States delegation.

60. Mr. BURMAN (United States of America) said he recognized the concerns expressed. He suggested that the issue should be highlighted in the commentary, subject to the Commission's determination of the term and status of the commentary. Those who had not had the benefit of attending the working groups would then have the opportunity to see what kind of subjects were relevant, subject to the comments and observations made in relation to articles 4, 11 and 12.

61. Ms. McMILLAN (United Kingdom), referring to the fourth preambular paragraph, suggested that when the Working Group reconvened it should consider inserting an additional paragraph to highlight the fact that, while adequate protection for the interests of the debtor should be secured, national law would be preserved in important areas such as preferential creditors and the national system of land registration which governed priority.

62. The CHAIRMAN noted that the Commission was aiming to complete the preamble at the present session. The Working Group's time could be used optimally in relation to those provisions that it had not yet considered.

63. Ms. GAVRILESCU (Romania) associated herself with the views expressed by the delegate of the United Kingdom. She would not object to the present text of the fourth preambular paragraph, but she supported the proposed addition.

64. Mr. WINSHIP (United States of America) said that the terms of reference for the Working Group should all be decided at the same time. If they were to accept the United Kingdom proposal, additional concerns might also be added to the preamble during the consideration of the draft text, and the preamble would become unnecessarily long. He preferred to retain the present wording of the fourth preambular paragraph.

65. Mr. DOYLE (Observer for Ireland) agreed with the previous speaker. He appreciated the merits of the United Kingdom proposal, but the aim of the present debate was to finalize the preamble. The Commission should not consider any additional proposals.

66. Mr. MORÁN BOVIO (Spain) said that the purpose of the present exercise was to decide whether to retain or delete the sections of the text marked by square brackets. His delegation had difficulty with the United Kingdom suggestion because international trade law was not intended to reduce or diminish national law, nor to attack established legal practices for dealing with real estate issues.

67. Mr. HERRMANN (Secretary of UNCITRAL) pointed out that the concern to preserve national law had been highlighted several times in the guide to enactment of the recently adopted Model Law on Cross-Border Insolvency, although the preamble to that text did not refer to the issue. It would be consistent to proceed along similar lines.

68. The CHAIRMAN said that the fourth preambular paragraph would remain as it was.

69. Mr. RENGER (Germany), referring to the fifth preambular paragraph, suggested that the words "in", "financing" and "capital and", which were in square brackets in the text, should be deleted.

70. Ms. WALSH (Observer for Canada) said she agreed with the previous speaker but would prefer to retain the words "capital and", which would allow the text to more accurately reflect the dual use of assignment of receivables in the context of the draft Convention, both in the sale or transfer of the receivables and in their use as collateral in a secured credit transaction. The reference to "credit" alone would not capture the full breadth of the draft Convention.

71. Mr. MORÁN BOVIO (Spain), Ms. STRAGANZ (Austria) and Mr. WINSHIP (United States of America) supported the Canadian proposal.

72. Mr. BERNER (Observer for the Association of the Bar of the City of New York), in the absence of his colleagues from EUROPAFACTORING and Factors Chain International, endorsed the Canadian proposal.

73. Mr. MOHAMED (Nigeria) said that the reference to promoting the availability of capital and credit should precede the reference to the development of international trade.

74. Mr. TELL (France) supported the Nigerian proposal to reverse the two clauses in the fifth preambular paragraph. Promotion of the availability of capital and credit would by definition help to facilitate the development of international trade. It was more logical to move from a particular to a general reference.

75. Ms. McMILLAN (United Kingdom) said that the preamble was important and should refer to the most significant points of the draft Convention. She therefore supported the Nigerian proposal.

76. Mr. MORÁN BOVIO (Spain) and Ms. SABO (Observer for Canada) also supported the Nigerian proposal.

77. Mr. AL-NASSER (Observer for Saudi Arabia) supported the wording proposed by the Nigerian and Canadian delegations.

78. The CHAIRMAN said he took it that the Commission accepted the Nigerian proposal. The secretariat would redraft the paragraph.

The meeting rose at 1 p.m.

Summary record of the 697th Meeting

Monday, 26 June 2000, at 3 p.m.

[A/CN.9/SR.697]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 3.05 p.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4; A/CN.9/XXXIII/CRP.2 and Add.1 and 2)

1. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) pointed out that the reference to "receivables financing" in the title and preamble to the draft Convention had now been deleted. Accordingly, draft article 6 *(c)*, which contained a definition of receivables financing and which had been left in square brackets, could now be deleted.

2. Mr. MORÁN BOVIO (Spain) and Mr. KOBORI (Japan) supported that suggestion.

3. The CHAIRMAN said that, in the absence of objection, he would take it that draft article 6 *(c)* should be deleted.

4. *It was so decided.*

Report of the Drafting Group (continued) (A/CN.9/XXXIII/CRP.2 and Add.1 and 2)

5. The CHAIRMAN invited the Commission to adopt draft articles 1 to 17, as contained in the report of the Drafting Group, with the exception of the language in square brackets.

Draft article 1 (A/CN.9/XXXIII/CRP.2)

6. *Paragraphs (1) (2) and (3) of draft article 1 were adopted.*

7. The CHAIRMAN said that a decision on paragraph (4) should be deferred, since it referred to a question not yet resolved by the Commission.

8. Mr. RENGER (Germany) said that paragraph (5) could only be finally approved once the annex to the draft Convention had been adopted, since the Commission had not yet discussed the connection between the annex and draft article 40.

Draft article 2 (A/CN.9/XXXIII/CRP.2)

9. Mr. TELL (France) said that the wording of draft article 2 referred only to the assignment of contractual receivables and did not make provision for non-contractual receivables. That was a serious shortcoming and might deter States in which transactions in non-contractual receivables were widespread from ratifying the future Convention. His delegation intended to consult with financial circles on the matter, with a view to making a declaration at the appropriate time that would provide for an "opt-in" arrangement for such practices.

10. The CHAIRMAN asked whether the representative of France wished the adoption of that article to be deferred.

11. Mr. TELL (France) said in clarification that he was suggesting another solution, namely, a declaration whereby provision could be made for the assignment of non-contractual receivables in those States wishing to enable their economic operators to benefit from such transactions. He thought it unlikely that other States would object to such a solution.

12. *Draft article 2 was adopted.*

Draft article 3 (A/CN.9/XXXIII/CRP.2)

13. *Draft article 3 was adopted.*

Draft article 4 (A/CN.9/XXXIII/CRP.2 and Add.1 and 2)

14. Mr. WINSHIP (United States of America) said that the Drafting Group had agreed to delete the words "To the extent" in paragraph (1) *(b)*. The text would then read: "Made by the delivery of a negotiable instrument, with an endorsement, if necessary;".

15. Mr. RENGER (Germany) said that the language of paragraph (3) *(a)*, stating that the Convention did not "affect the question whether", was too colloquial for a legal instrument and was therefore unsatisfactory.

16. Ms. McMILLAN (United Kingdom) said that the Commission had intended, in paragraph (3) *(a)*, to state that the application of the future Convention to assignment of a receivable would not affect a right to real estate. It was important to make clear, in the new wording, that the draft Convention did not seek to change substantive law in respect of land or real estate. She hoped that the secretariat would be able to reformulate the subparagraph in that light.

17. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) said that paragraph (3) *(a)* should be understood in the opposite sense: a right in real estate did not affect a right in a receivable related to it. Depending on the wishes of the Commission, subparagraphs *(a)* and *(b)* could be merged in order to state that the Convention would not affect priority rights to receivables in a conflict between holders of rights to real estate.

18. The CHAIRMAN said that the intention underlying subparagraph *(a)* was to establish the principle on which the rule in subparagraph *(b)* was based.

19. Ms. GAVRILESCU (Romania) said that a proper distinction must be drawn between priority rights and property rights in real estate, which were quite different things. Also, the word "or" in subparagraph *(b)* should be deleted.

20. Mr. WINSHIP (United States of America) said he could agree to the deletion of the word "or" in subparagraph *(b)*. With regard to the question addressed by the representative of the United Kingdom, he supported the suggestion by the Secretary of the Working Group that subparagraphs *(a)* and *(b)* of paragraph (3) should be combined, to make clear that the priority rules concerning a right in real estate, if there was such a right, would be determined by law other than the Convention.

21. Mr. DOYLE (Observer for Ireland) shared the doubts of the United Kingdom representative concerning the language of subparagraph *(a)*. He supported the suggestion of combining subparagraphs *(a)* and *(b)*.

22. Mr. TELL (France) said that subparagraphs *(a)* and *(b)* of paragraph (3) were indissolubly linked, the second being dependent on fulfilment of the condition in the first. Subparagraph *(b)* should be clarified; he suggested amending "the right of an assignee of the receivable" to read "the right of an assignee to that receivable". He agreed with the representative of Romania that the subject-matter of subparagraphs *(b)* and *(c)* should be clearly distinguished. However, it was not necessary to delete the word "or", which was merely a stylistic device, although that could be done if subparagraphs *(a)* and *(b)* were combined. In the French version of paragraphs 2 *(d)* and 2 *(f)* "investment securities" should have been translated as "*valeurs mobilières*", not as "*titres de placement*".

23. Mr. AL-SAIDI (Observer for Kuwait) asked whether draft article 4 would be reviewed by the Working Group. Paragraph (2) *(a)* contained an exclusion for receivables arising from transactions on a regulated exchange; he did not recall any discussion of that provision by the Commission.

24. Mr. MORÁN BOVIO (Spain) welcomed the proposal to combine subparagraphs *(a)* and *(b)* of paragraph 3, which would help to clarify its meaning.

25. Ms. WALSH (Observer for Canada), supported by Mr. MORÁN BOVIO (Spain), suggested that, since the current wording of subparagraphs *(a)* and *(b)* of paragraph (3) was sufficiently clear, they should be combined by adding the word "and" at the end of subparagraph *(a)* and deleting the initial word "Affect" in subparagraph *(b)*. The word "or" at the end of former subparagraph *(b)* should probably remain.

26. Ms. GAVRILESCU (Romania) said that, if the various parts of the provision were clear, there was no need for such linking words as "or", which could create uncertainty. If the Commission insisted on some sort of link, however, her delegation preferred the conjunction "and".

27. Mr. MOHAMED (Nigeria) said that subparagraph *(a)* was not well drafted, but he could agree to combining it with subparagraph *(b)*. For the sake of logic, it would be better to start paragraph (3) with subparagraph *(c)*.

28. The CHAIRMAN said that the Commission was clearly in favour of combining subparagraphs *(a)* and *(b)* of paragraph (3), and there was some support for the deletion of "or".

29. After a procedural discussion in which Mr. MORÁN BOVIO (Spain), Mr. RENGER (Germany), Mr. BURMAN (United States of America) and the CHAIRMAN took part, Ms. WALSH (Observer for Canada) suggested that some delegations should consult informally and return with a text.

30. The CHAIRMAN said that, in the absence of objection to that suggestion, further consideration of draft article 4 would be deferred for the time being.

Draft articles 5, 6 and 7 (A/CN.9/XXXIII/CRP.2)

31. The CHAIRMAN recalled that it had been decided to delete subparagraph *(c)* of draft article 5.

32. *Draft articles 5, 6 and 7 were adopted.*

Draft articles 8, 9 and 10 (A/CN.9/XXXIII/CRP.2/Add.1)

33. *Draft articles 8, 9 and 10 were adopted.*

Draft article 11 (A/CN.9/XXXIII/CRP.2 and Add.1 and 2)

34. Mr. TELL (France), referring to the revised version of article 11 (3) (a) as it appeared in document A/CN.9/XXXIII/CRP.2/Add.2, which dealt, inter alia, with receivables arising under an original contract for the supply or lease of goods, said that the English term "goods" had in the French version been translated in a drastically restricted manner as "*bien meubles corporels*", (tangible assets). His delegation did not see why intangible assets (*bien meubles incorporels*) should have been excluded from the scope of the draft article, especially when they were far more important to businesses in the modern economy than mere merchandise. The misunderstanding stemmed from an original United States proposal regarding article 11 (3) *(a)* that had been very restrictive. He was not suggesting that the debate in the Commission should be reopened; but he did believe the matter needed to be referred to the Working Group.

35. Ms. WALSH (Observer for Canada) said that it was only in the Drafting Group that the policy difference had come out. With some reluctance, her delegation suggested placing the English and French terms in square brackets, so that the Working Group could discuss the question fully and make its proposal at the next session.

36. Mr. BAZINAS (Secretary of the Working Group on International Contract Practices) confirmed that the issue had been discussed in the Drafting Group, where it had been agreed that the term "goods" was always to mean movable, tangible goods. That instruction had been given also to the language revisers. The Commission, had never discussed the matter of intangible assets, however, and consequently had not given the Drafting Group a policy decision to implement in the matter.

37. Mr. DOYLE (Observer for Ireland) said that there were indeed issues of substance involved and the Working Group might have to take the matter up.

38. Mr. BURMAN (United States of America) said that the decision described by the Secretary had been taken in the Working Group after an extended discussion in which concerns had been fully expressed about the inclusion of intangible goods. His delegation believed that the text should stand but would not oppose its being taken up again by the Working Group.

39. The CHAIRMAN recalled that there was a clear decision of the Commission that the Working Group was not to reopen any matters that had been settled.

40. Mr. MORÁN BOVIO (Spain) said that he reluctantly favoured putting the terms in square brackets and asking the Drafting Group to work further on the text.

41. Mr. TELL (France) said that the Commission itself had never discussed the term in question nor taken a policy decision as to whether its scope was restricted to tangible assets. To his delegation it was obvious that the term covered intangible assets. The Working Group must work on the question.

42. The CHAIRMAN said he took it that the Commission wished to put the terms "goods" and "*corporels*" in square brackets for further discussion and to adopt draft article 11 with the exception of the bracketed language.

43. *It was so decided.*

44. *Draft article 11 was adopted.*

Draft article 12 (A/CN.9/XXXIII/CRP.2 and Add.1 and 2)

45. The CHAIRMAN said he took it that, in keeping with the decision just taken on draft article 11 (3) *(a)*, the Commission wished to put in square brackets the terms "goods" and "*incorporels*" in the English and French versions of article 12 (4) *(a)*.

46. *It was so decided.*

47. Mr. DESCHAMPS (Observer for Canada) said that the French text of article 12 (5) differed from the English text and that he would be suggesting changes.

48. *Draft article 12 was adopted.*

Draft articles 13 to 17 (A/CN.9/XXXIII/CRP.2 and Add.2)

49. The CHAIRMAN noted that the term "receivables financing" in article 13 (3) was no longer in square brackets.

50. *Draft articles 13, 14, 15, 16 and 17 were adopted.*

The meeting was suspended at 4.35 p.m. and resumed at 5 p.m.

51. The CHAIRMAN recalled that article 12 had been adopted subject to drafting changes in paragraph (5) of the French text (A/CN.9/XXXIII/CRP.2/Add.1) to bring it into line with the English.

52. Mr. DESCHAMPS (Observer for Canada), speaking on behalf of the francophone delegations, proposed that paragraph (5) of the French text should read:

> "Le transfert visé au paragraphe 1 du présent article d'une sûreté comportant des possessions n'a pas d'incidences sur les obligations du cédant envers le débiteur ou la personne qui accorde la sûreté relative au bien transféré en vertu de la loi régissant cette sûreté.".

53. *It was so decided.*

Draft article 4 (continued) (A/C.9/XXXIII/CRP.2 and Add.1 and 2)

54. The CHAIRMAN recalled that, in the light of the strong support for combining paragraphs 3 *(a)* and *(b)* of draft article 4 as they appeared in document A/CN.9/XXXIII/CRP.2/Add.2 and the proposal for the deletion of the conjunction "or", the Commission had decided that the English-speaking delegations should consult informally with a view to producing a text that incorporated those changes.

55. Mr. WINSHIP (United States of America), speaking also on behalf of the Canadian and German delegations, said that they had agreed on the following text:

> "*(a)* Affect whether a property right in real estate confers a right in a receivable related to that real estate, and does not determine the priority of such a right in the receivable with respect to the competing right of an assignee of the receivable;".

56. The conjunction "or" following the semi-colon and preceding paragraph *(c)* should be deleted.

57. Ms. GAVRILESCU (Romania) said that her delegation fully supported the United States proposal.

58. Ms. LI LING (China) said that it was not clear to her delegation why the verb "determine" had been substituted for "affect". She questioned the repetition of the words "does not", since they already appeared in the chapeau.

59. Mr. BURMAN (United States of America) said it had been felt that the words "affect" and "determine" were each appropriate, in English, to the contexts in which they were used.

60. Mr. RENGER (Germany) said that the delegations involved thought that the proposed language was an improvement over the previous version. It might be further improved at some point in the future, but he thought a decision could be taken on the policy implications of the wording proposed.

61. Mr. TELL (France) said that he reserved the right to comment once he had seen the French version of the proposal. He wished to stress the difficulties of working on a proposal available in only one language, especially when the proposal was not in writing. His initial impression was that the only substantive change was the introduction of the word "competing", which was acceptable to his delegation. Any other problems were a matter of drafting, which need not be dealt with in the plenary Commission.

62. The CHAIRMAN said he took it that the proposed wording combining subparagraphs *(a)* and *(b)* of paragraph (3) was acceptable in the English version; the other language versions would be adjusted accordingly. The present subparagraph *(c)*, as it appeared in document A/CN.9/XXXIII/CRP.2/Add.1, would become subparagraph *(b)*.

63. *Draft article 4, as orally revised, was adopted.*

64. The CHAIRMAN recalled that, at its previous meeting, the Commission had considered whether the draft Convention should be referred back to the Working Group.

65. Mr. MOHAMED (Nigeria) proposed that any further consideration of the draft Convention should be undertaken by the Commission, since it was important to achieve the broadest possible participation and Governments of developing countries would be more willing to finance their representatives' attendance at a resumed session of the Commission, which might be convened in January 2001, than at meetings of the Working Group. Furthermore, if the draft Convention was returned to the Working Group, any revisions made would have to be transmitted to States for comments prior to their consideration by the Commission, which was not practical given the short time available.

66. Mr. BURMAN (United States of America) said that his delegation would have no objection to either course of action.

67. Mr. RENGER (Germany) agreed that the convening of a resumed session of the Commission might result in a larger attendance and would certainly expedite the finalization of the draft Convention.

68. Mr. PANG KHARG CHAU (Singapore) said that his delegation supported the Nigerian proposal.

69. Mr. MORÁN BOVIO (Spain) said that the draft Convention should be referred back to the Working Group for reasons of both tradition and economy. No summary records would be produced for meetings of the Working Group, which would result in a considerable saving.

70. Ms. SABO (Observer for Canada) said that, if a resumed thirty-third session was convened in January 2001, the Commission's thirty-fourth session in May would have to be truncated by at least one week. It would be more efficient to refer the draft Convention back to the Working Group.

71. Mr. TELL (France) said that his delegation remained convinced that it would be better for the Commission itself to finalize the text at its thirty-fourth session since the Working Group had already completed its work. Sending the text back to the Working Group would mean that issues on which the Commission had already taken a decision would be reopened, which would be procedurally irregular. His delegation would, however, be prepared to endorse the Nigerian proposal, which constituted a good compromise since it took account of the concerns of delegations that wished to avoid delays in adopting the draft Convention.

72. Mr. MARADIAGA (Honduras) said that, if the Working Group met in December and a resumed session of the Commis-

sion was convened shortly thereafter to consider the outcome of the Working Group's work, the adoption of the draft Convention could be expedited considerably.

73. Mr. GHAZIZADEH (Islamic Republic of Iran) said that his delegation was in favour of sending the draft Convention back to the Working Group.

74. Mr. DOYLE (Observer for Ireland), supported by Mr. MARKUS (Observer for Switzerland), said that there appeared to be only limited support for the Nigerian proposal, whereas, at the Commission's previous meeting, a clear majority had favoured returning the text to the Working Group. He saw no need to prolong the discussion.

75. Mr. LAMBERTZ (Observer for Sweden) said that further work on the draft Convention was needed before the Commission reverted to it. He therefore agreed that it should be sent back to the Working Group.

76. The CHAIRMAN said, he took it that the Commission wished to return the draft Convention to the Working Group.

77. *It was so decided.*

78. The CHAIRMAN then invited the Commission to consider the terms of reference of the Working Group.

79. Ms. SABO (Observer for Canada) said that the delegations which had consulted on the terms of reference she was about to propose had attempted to address concerns that the Working Group should not reopen questions already settled. The proposal was in four parts:

> "1. Beginning with article 18, the Working Group should review those parts of the draft Convention that the thirty-third session of the Commission has not had the opportunity to examine and the text remaining in square brackets in articles 1 to 17.
>
> "2. In light of the modifications made to articles 1 to 17, the Working Group should ensure that the coherence and consistency of the text are maintained.
>
> "3. If, as a result of its consideration of articles 18 through to the annex, the Working Group identifies issues in articles 1 to 17, it should bring these issues to the attention of the Commission with an appropriate explanation and a recommendation, if possible.
>
> "4. As to its working methods, the Working Group should adopt the same approach as the Commission, that is, it should make only those changes that meet with substantial support."

As it worked on articles 18 and following of the draft Convention, the Working Group would identify changes it believed to be necessary in articles 1 to 17 and, rather than alter the text, would make recommendations for the Commission's consideration.

80. Mr. WINSHIP (United States of America) said that there were two pieces of unfinished business the Working Group might also be asked to undertake. First, it might consider the UNIDROIT proposal (A/CN.9/XXXIII/CRP.7), which related to the topic of conflicts with other international agreements dealt with in the second part of the draft Convention. Second, the Working Group might address the question whether a limited definition of location should be devised for financial institutions. When the Commission had considered a general definition of location and a general provision for branches, there had been some support for a specific rule for branches of financial institutions.

81. In general, the Working Group should not touch the wording of articles 1 to 17, but it might be asked to polish the wording of article 4 (3) *(a)*, from a purely editorial standpoint.

82. Mr. TELL (France) said that the Canadian proposal was very helpful, although it appeared necessary to clarify the mandate of the Working Group with respect to articles 1 to 17. Given the mention of consistency in paragraph 2 of the proposal, for example, he was not sure whether the Working Group was being instructed to make its work on articles 18 through to the annex consistent with articles 1 to 17 or the reverse.

83. His delegation's position was that the Working Group should not touch articles 1 to 17, except for purely editorial reasons. For that reason, it opposed the suggestions by the representative for the United States. Although his delegation was favourable to the idea of a specific rule for branches of financial institutions, since the Commission had discussed the matter at length, it was for the Commission itself to take the matter further at its next session, if it wished. Matters debated by the Commission should not be re-debated by the Working Group; to make exceptions was to open Pandora's box. The same arguments applied to the question of the UNIDROIT draft Convention on International Interests in Mobile Property, but in the latter case there was the additional consideration that on UNIDROIT's side no considerable progress would have been made by the time the Working Group met.

84. Ms. GAVRILESCU (Romania) said that the terms of reference should make clear that, in accordance with Commission policy, everything the Commission had approved and adopted should be left untouched. The Working Group should be specifically instructed not to debate questions and policy already settled or to reopen discussion of articles 1 to 17.

85. Ms. SABO (Observer for Canada) said that her delegation agreed with the French representative that no exceptions should be made to the rule that issues debated by the Commission should remain the concern of the Commission.

86. Mr. PANG KHARG CHAU (Singapore) said he was sure that it was not the intent of the Canadian proposal to authorize the Working Group to alter articles 1 to 17. The language of the proposal might be clarified by adding the words "in reviewing articles 18 through to the annex" to paragraphs 2 and 4 of the proposal, which would make clear that the Working Group must align its thinking with that of the Commission and not the reverse. However, it was perfectly acceptable for the Working Group to make recommendations regarding articles 1 to 17, pursuant to paragraph 3 of the proposal, if it detected difficulties.

ELECTION OF OFFICERS *(continued)*

87. Mr. MOHAMED (Nigeria), speaking on behalf of the Group of African States, nominated Mr. Gamledin Awad (Egypt) for the office of Vice-Chairman.

88. *Mr. Gamledin Awad (Egypt) was elected Vice-Chairman by acclamation.*

89. Ms. VIRBICKAIRE (Lithuania), speaking on behalf of the Group of Eastern European States, nominated Ms. Gavrilescu (Romania) for the office of Vice-Chairman.

90. *Ms. Gavrilescu (Romania) was elected Vice-Chairman by acclamation.*

The meeting rose at 6.05 p.m.

Summary record of the 698th Meeting

Tuesday, 27 June 2000, at 10 a.m.

[A/CN.9/SR.698]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.10 a.m.

DRAFT CONVENTION ON ASSIGNMENT OF RECEIVABLES *(continued)* (A/CN.9/466, 470, 472 and Add.1-4)

1. The CHAIRMAN invited the Commission to consider the proposal submitted by the representative of Canada at the 697th meeting on the terms of reference for the Working Group on International Contract Practices, in accordance with which the Working Group was to examine articles 1-17 of the draft Convention and, where necessary, introduce any changes. A counter-proposal from the Singapore delegation held that the Working Group should restrict itself to making the draft Convention internally consistent. It should not introduce changes to articles that had already been settled.

2. Ms. SABO (Observer for Canada) said that there was little difference between her delegation's proposal and that of the Singapore delegation. Both required that the Working Group should make no policy changes.

3. Mr. MORÁN BOVIO (Spain) expressed a preference for the approach suggested by the Canadian delegation. The Working Group had proved its competence and ability to solve problems. The draft Convention had been completely restructured by the Commission, and any attempt to tie the Working Group's hands might limit its ability to fulfil its mandate. The Canadian proposal had the requisite degree of both strictness and flexibility. Any narrower terms of reference would imply mistrust of the Working Group.

4. Mr. WINSHIP (United States of America) said that his delegation saw little substantial difference between the two proposals, since the Commission would in any case review the Working Group's conclusions. He wished, however, to propose that if any time remained after the completion of its other work, the Working Group should consider a further point of substance, namely, the status of mobile equipment under the draft Convention. As stated in document A/CN.9/XXXIII/CRP.1/Add.9, paragraph 22 *quater*, the Committee had decided to defer a decision until the Draft Convention on International Interests in Mobile Equipment and its protocols on aircraft, space equipment and railway rolling stock ("the UNIDROIT draft Convention") was closer to completion. That was not the only consideration, however; it was also possible that the draft Convention on assignment of receivables might be intrinsically inappropriate to mobile equipment in view of the working practices of the industries involved. It was an open issue that needed to be settled. The question was whether it should be entrusted to the Working Group or should await the attention of the full Commission. His delegation's preference would be for the former option.

5. The CHAIRMAN said that, since the issue had not been addressed during the Commission's recent deliberations, it would be advisable not to extend the Working Group's terms of reference.

6. Mr. ONG (Singapore) said that he had understood the Canadian proposal to be close to that of his own delegation. It appeared, however, that the Canadian delegation would countenance the Working Group's making changes to the text in relation to issues that the Commission had already settled. The Working Group could naturally recommend changes, but its entitlement to introduce changes on its own initiative should be restricted to article 18 onwards. If the Working Group redrafted the whole text it would cast doubt on the value of the Commission's work over the past two weeks.

7. Mr. MARADIAGA (Honduras) said that the Commission should not hamstring the Working Group. Significant changes had been made to the draft Convention, so the Working Group would obviously have to review some articles whose content had been decided. It would, of course, have to explain to the Commission any changes that it might make.

8. Mr. RENGER (Germany) said that a considerable number of issues remained open, even in articles 1-17, such as the question of mobile equipment and, if his understanding was correct, the question of location in the context of financial services. The Working Group should not only aim to make the text internally consistent but it should also be empowered to make recommendations.

9. Ms. GAVRILESCU (Romania) expressed her delegation's support for the view that policy decisions already reached by the Commission should not be reopened. There was, however, no reason why the Working Group should not discuss—and have included in its terms of reference—the issues mentioned by the representatives of the United States and Germany.

10. Mr. GHAZIZADEH (Islamic Republic of Iran) concurred with the representative of Spain in supporting the Canadian proposal as it stood. There was no need to impose narrow restrictions on the Working Group.

11. Mr. ATWOOD (Australia) said that, if the Canadian proposal was that the Working Group should be charged with reviewing articles 1-17 and changing the order and wording in the interests of making the text clearer, his delegation was in favour of it. As for the United States proposal, he saw no objection to the Working Group's considering the issue of mobile equipment, provided that it did so after completing the rest of its mandate.

12. The CHAIRMAN said that any fears that in reordering the language of the draft Convention the Working Group would change decisions reached by the Commission had surely been allayed. He wished it formally understood, however, that the Working Group should not change any policy agreed on by the Commission. He also saw merit in the suggestion by the representative of Australia that the issue of mobile equipment should be broached only after the completion of the Working Group's other work. On that understanding, he took it that the Commission wished to adopt the terms of reference submitted by the Canadian delegation.

13. *It was so decided.*

DRAFT LEGISLATIVE GUIDE ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS (A/CN.9/471 and Add.1-9)

14. Mr. ESTRELLA FARIA (International Trade Law Branch) recalled that the entire text of the draft legislative *Guide* had had its first reading before the Commission and some chapters their second. Following the thirty-second session, the secretariat had, in accordance with the Commission's instructions, convened an expert group to revise the legislative recommendations in their entirety and to make the text consistent and concise. To that end, some chapters had been merged and repetitious material eliminated, while taking account of the Commission's decisions. It had been agreed at the previous session that the substance of the draft guide was broadly acceptable. It therefore remained for the Commission only to consider the draft legislative recommendations contained in document A/CN.9/471/Add.9. There was no need to consider the accompanying notes, which provided a commentary.

15. The CHAIRMAN invited the Commission to consider the draft legislative recommendations contained in document A/CN.9/471/Add.9 one by one, referring to the notes only when necessary.

16. Mr. WALLACE (United States of America) said that his delegation would refrain from commenting on the majority of the recommendations in the hope that the current exercise could be concluded rapidly and that the Commission would then decide to extend the project through the inclusion of model provisions or a model law on privately financed infrastructure projects.

17. Mr. SARIE-ELDIN (Egypt) said that he strongly supported the proposal for a model law.

18. Ms. NIKANJAM (Islamic Republic of Iran) said that a model law would be of great use to Governments such as her own.

19. Mr. LALLIOT (France) pointed out that in the foreword to the *Guide*, the user was advised to read the legislative recommendations together with the notes; thus, there was little need for further amendment of the former. However, he agreed with the representative of the United States of America that chapters 1 and 7 could be combined.

20. Mr. WIWEN-NILSSON (Observer for Sweden) said that while he was in favour of discussing the possible development of a model law, such discussion should not begin until the Commission had completed its work on the recommendations in order not to delay finalization of the *Guide*.

Chapeau (A/CN.9/471/Add.9)

21. Mr. REICHEL (Observer for the World Bank) suggested that the chapeau would be improved by the addition of a general admonition that the greater the number of restrictions under domestic law, the harder it would be to implement the projects covered by the *Guide*; the contracting authorities should be given as much flexibility as possible.

22. Mr. RENGER (Germany) said that new issues should not be raised at such a late stage of the Commission's work.

23. Mr. DARCY (United Kingdom) said that the wording of the chapeau had been carefully chosen and should be left unchanged. It was important for States to realize that if they were serious in their desire to implement privately financed infrastructure projects, the *Guide* must be followed quite closely; there was very little room for compromise.

24. The CHAIRMAN suggested that the Commission might consider adding a specific recommendation embodying the World Bank proposal rather than amending the chapeau.

25. Mr. WIWEN-NILSSON (Observer for Sweden) noted that the point raised by the observer for the World Bank had already been made elsewhere in the recommendations and the notes, which had been drafted with care in order to ensure maximum flexibility for the contracting authorities.

26. Mr. LALLIOT (France) said that in view of the Commission's time constraints, it would be best to leave the recommendations in their current form. The World Bank proposal was unnecessary and might even lead to confusion: it constituted a statement rather than a recommendation and, as the observer for Sweden had noted, the underlying principle was already present in the document as a whole. In any case, the contracting authorities must not be led to believe that they were free to do as they liked rather than following the Commission's recommendations.

27. The CHAIRMAN said that there seemed to be little support for the World Bank proposal.

Draft recommendation 1

28. Ms. SANDERSON (Observer for Canada) said that since the words "legislative and institutional framework" were mentioned in the recommendation, they should perhaps be included in the chapeau as well.

29. The CHAIRMAN suggested that the matter should be referred to the secretariat.

30. Mr. SARIE-ELDIN (Egypt) suggested that "constitutional," should be inserted before "legislative".

31. The CHAIRMAN said that if there was no objection, he would take it that the Commission wished to approve that amendment.

32. *It was so decided.*

33. Ms. NIKANJAM (Islamic Republic of Iran) proposed that the recommendation should be amended to make it clear that all parties, including the host country, should eliminate undesirable restrictions to private sector participation in infrastructure development and operation.

34. Mr. ESTRELLA FARIA (International Trade Law Branch) said that that point had been made elsewhere.

35. Ms. NIKANJAM (Islamic Republic of Iran) replied that it should also be made in recommendation 1 in order to give it the full authority of the Commission.

36. The CHAIRMAN said that there seemed to be little support for the Iranian proposal.

37. Mr. WIWEN-NILSSON (Observer for Sweden) said that since the *Guide* did not constitute a legal instrument open to interpretation, he saw little need for redrafting.

38. *Draft recommendation 1, as orally amended, was adopted.*

Draft recommendation 2

39. Mr. SARIE-ELDIN (Egypt) suggested that the words "to grant the concession and" should be inserted after "empowered".

40. Mr. ESTRELLA FARIA (International Trade Law Branch) said that reference to the granting of concessions had been deliberately avoided in the recommendations because not all national systems distinguished between concessions and project agreements. However, the expression "contracting authority" was defined in paragraph 17 of document A/CN.9/471/Add.1 and should be sufficient.

41. Mr. SARIE-ELDIN (Egypt) said that the use of that expression did not resolve the underlying problem. Some legal systems made a distinction between the contracting authorities and the granting authorities, and it was important to specify which of them was empowered to grant the necessary licences.

42. Mr. WALLACE (United States of America) said that although the United States of America was not a civil law jurisdiction, his delegation supported the Egyptian proposal.

43. The CHAIRMAN said that if there was no objection, he would take it that the Commission wished to approve the proposal made by the representative of Egypt.

44. *It was so decided.*

45. *Draft recommendation 2, as orally amended, was adopted.*

Draft recommendation 3

46. Mr. WALLACE (United States of America) proposed that the words "and ownership" should be added after one of the two instances of the word "operation".

47. Mr. DARCY (United Kingdom) proposed the addition of the words "and financing" before "of existing" and the deletion of the word "and" before "operation".

48. Mr. LALLIOT (France) said that he could not support the proposal made by the representative of the United States of America because some legal systems did not permit the granting of concessions for ownership. In reply to the representative of the United Kingdom, he said that the issue of financing was dealt with elsewhere and should not be raised in recommendation 3.

49. Mr. SARIE-ELDIN (Egypt) said that although his own country had a civil law system, he had no objection to the amendments proposed by the representatives of the United States of America and the United Kingdom. With respect to the first point raised by the representative of France, he noted that the words "may include" made it clear that inclusion would depend on whether private ownership of property was permitted under a given legal system.

50. Mr. ONG (Singapore) said that he agreed with the representative of France. The main purpose of the project was to promote the construction, expansion and operation of infrastructure; ownership was a subsidiary issue which, like occupation, lease and transfer, was dealt with in the notes.

51. Mr. WIWEN-NILSSON (Observer for Sweden) said that the purpose of the recommendation was to cover the construction or refurbishment of infrastructure. However, the question of ownership was raised in document A/CN.9/471/Add.2, paragraph 9, and the Commission might wish to discuss whether to consider the desirability of restrictions on the ownership of public property in connection with recommendation 1.

52. Mr. RENGER (Germany) said that he agreed with the observer for Sweden; mention of ownership in recommendation 3 would cause serious problems.

53. Ms. FOLLIOT (France) said that in any case, the issue was covered adequately in chapter VII, paragraphs 7-9 (A/CN.9/471/Add.8).

54. Ms. GAVRILESCU (Romania) and Mr. MARADIAGA (Honduras) said that they associated themselves with the comment made by the representative of France.

55. The CHAIRMAN said that there appeared to be a consensus that recommendation 3 should remain unchanged.

56. *Draft recommendation 3 was adopted.*

Draft recommendation 4

57. Mr. MORENO RUFFINELLI (Paraguay) said that the recommendation should be made more flexible, since developing countries might need to amend their legislation periodically in order to establish new sectors.

58. Ms. NIKANJAM (Islamic Republic of Iran) suggested that the problem could be solved by replacing the word "should" with "may".

59. Mr. PINZÓN SÁNCHEZ (Colombia) said while he had no objection to that suggestion, it might be better to state that the law should identify the sectors or types of infrastructure in respect of which concessions could not be granted.

60. Mr. RENGER (Germany) said that the Commission should be very careful about changing anything in that carefully worded recommendation. The word "should" was used in other recommendations, and had a stronger meaning than the word "may". He did not foresee any problems with priority questions or negative lists. The law should identify the relevant sectors, and that could be done in a positive or negative way.

61. Ms. NIKANJAM (Islamic Republic of Iran) noted that the word "may" was used in recommendation 3, admittedly in a slightly different context. However, she would accept the secretariat's decision.

62. Mr. MORENO RUFFINELLI (Paraguay) said he had interpreted the recommendation rather differently from the secretariat, understanding it as an unnecessary limitation of the sectors in which the privately financed infrastructure projects might take place.

63. Mr. LALLIOT (France) said he shared the views of the German delegation. The Commission had instructed the secretariat to find wording for the recommendation to make it sound like an incentive. In response to the comment by the Iranian delegation, he noted that the word "may" was used in recommendation 3 in the context of a more general statement, rather than an address to those States which were interested in following the guide's recommendations.

64. The Colombian proposal to make it a negative formulation was worthy of consideration.

65. The CHAIRMAN noted that the issue had been discussed at a previous meeting, and it had been decided that the recommendation should not be formulated in a negative manner.

66. Mr. MARADIAGA (Honduras) said that the document was an extremely valuable instrument, containing very positive recommendations. His country, while following the work of the Commission, had already passed a law on concessions that was based on the draft *Guide*.

67. He shared the concern of the representative of Paraguay that some countries might have requirements that were not considered in the draft. The recommendation should be phrased in such a way that countries would be free to incorporate sectors that were not already specifically mentioned. Members should recall that the Commission was comprised of representatives of both developed and developing countries.

68. Mr. ONG (Singapore) noted that the concerns of the representatives of Paraguay and Honduras were probably addressed in paragraph 18 of document A/CN.9/471/Add.2, which indicated that recommendation 4 was not intended only as a positive delimitation of types of projects that would be permitted.

69. The CHAIRMAN noted that the recommendations were not intended to hamstring Governments but were offered for their consideration when dealing with publicly financed infrastructure projects in their countries.

The meeting was suspended at 11.45 a.m. and resumed at 12.10 p.m.

70. Mr. DARCY (United Kingdom) associated himself with the comments made earlier by the German delegation. The word "should" was very important because it made clear to potential private sector investors and bidders which areas they could legitimately take an interest in.

71. The CHAIRMAN said that, in the absence of a consensus, and in the light of the fact that some of the concerns expressed were addressed in the notes, he assumed that recommendation 4 would be accepted in its present form.

72. *Draft recommendation 4 was adopted.*

Draft recommendations 5-12

73. *Draft recommendations 5-12 were adopted.*

Draft recommendations 13 and 14

74. Mr. WALLACE (United States of America) suggested adding, after the word "support" in the second line, the words ", including public loans and guarantees, equity participations, subsidies and sovereign guarantees and assurances,". The wording was taken from the notes, but would make the recommendation clearer to the legislator. Alternatively, the new text could be added in the third line after the words "types of support".

75. Mr. SARIE-ELDIN (Egypt) wondered whether recommendation 13 was feasible at all, as it did not seem possible in practice to specify by law one authority to provide all the types of guarantees referred to.

76. Mr. WALLACE (United States of America) noted that the word "authorities" was used in the plural. It was essential to specify from which ministries or agencies guarantees could be obtained, as problems had arisen in the past when it had not been clear which body was responsible. There was a clear connection with recommendation 2.

77. The CHAIRMAN asked the secretariat whether the issue had been discussed at the previous session of the Commission.

78. Mr. ESTRELLA FARIA (International Trade Law Branch) noted that the recommendation did indeed reflect a policy directive of the Commission.

79. The term "public authorities" had been used in the plural to indicate that more than one might be specified, but the decision as to which authorities could provide which type of assurance was an internal matter for the host country. It would not necessarily mean that all have to be covered by the same piece of legislation, which was why the generic phrase "the law" had been used, without specifying which law.

80. Ms. FOLLIOT (France) and Mr. DARCY (United Kingdom) supported the United States proposal.

81. Ms. LI LING (China) and Mr. MARADIAGA (Honduras) preferred recommendation 13 to remain unchanged.

82. The CHAIRMAN, in the absence of a consensus, assumed that the concerns raised would be met by the text of the notes, and that the present wording of recommendation 13 would be retained.

83. *It was so decided.*

84. *Draft recommendations 13 and 14 were adopted.*

Draft recommendation 15

85. Mr. ESTRELLA FARIA (International Trade Law Branch) noted that the secretariat would be grateful if members of the Commission could point out any difficulties of translation in the Arabic, Chinese and Russian versions of the document. The secretariat could deal with the other languages involved.

86. In the French text of recommendation 15, the words used to translate the English expression "competitive procedures" seemed literally to mean "open procedure".

87. The term "competitive procedures" had been chosen after extensive discussions at previous sessions. It was understood to mean that prospective concessionaires would be invited to present offers and to compete with regard to the terms of their offers for the contract being offered. It was not a technical expression, as they did not want a term that referred to any specific type of procedure already known under domestic law. There had been an extensive debate on that issue, and on how the general provisions related to the exceptions described later in the chapter. There was no reference to bidding or tendering or other procedures used in other types of procurement contracts, as the chapter should not look like a general procurement code. The prospective concessionaires were to compete for the award of the project.

88. He asked the French-speaking members of the Commission to clarify whether that phrase adequately expressed the meaning of the English text.

89. Ms. FOLLIOT (France) said that *procédure ouverte* was the French term used in the European guidelines on the awarding of contracts. Therefore, if official terminology relating to public contracts was to be avoided, *procédure ouverte* could not be used. Her delegation proposed that the term should be replaced by *procédure de mise en compétition*, which did not have any special technical meaning and reflected the secretariat's point of view.

90. Mr. MAZZINI (Observer for Morocco) said that his delegation supported the French proposal. The Arabic translation of "competitive procedure" was correct.

91. Mr. SARIE-ELDIN (Egypt) said that chapter III contained no reference, either in the recommendations or the notes, as to whether the Commission wished to encourage legislators to have a specific law on the selection of the concessionaire, particularly for privately financed infrastructure projects. He wondered whether the Commission had considered that policy matter.

92. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the Commission had not made any strict recommendation as to whether such issues should be dealt with in one spe-

cific law or in several. In general, the approach that had been taken was that any piece of legislation that dealt specifically with privately financed infrastructure projects could either incorporate the entire selection process or simply contain a cross reference to the most appropriate procurement method obtainable in the host country.

93. Ms. GAVRILESCU (Romania), and Ms. ALLOUCH (Observer for Canada), supported the French proposal.

94. The CHAIRMAN said that the term proposed by the representative of France would replace the term *procédure ouverte* in the French text of recommendation 14.

95. *Draft recommendation 15, as orally amended, was adopted.*

Draft recommendations 16-20

96. *Draft recommendations 16, 17 and 19 were adopted.*

97. Mr. WALLACE (United States of America) said that, since recommendations 18 and 20 were related, the words "should invite" in recommendation 18 should be amended to read "should request" in order to be in line with the words "final request" in the first line of recommendation 20.

98. The CHAIRMAN said that the Commission accepted the editorial change proposed by the representative of the United States of America.

99. *Draft recommendations 18 and 20. as orally amended, were adopted.*

Draft recommendations 21 and 22

100. Mr. RENGER (Germany) said that, in an earlier document, recommendation 21 had appeared as recommendation 7, which had contained subparagraphs *(a)* and *(b)*. Subparagraph *(b)* dealt with the importance of the obligation to keep minutes of meetings of the bidders that were convened by the contracting authority. He wished to know why recommendation 21 did not reflect the content of recommendation 7, which he believed had been accepted by the Commission.

101. Mr. ESTRELLA FARIA (International Trade Law Branch) said that, in reviewing the recommendations with the assistance of outside experts, the secretariat had borne in mind one of the comments that had been made by the Commission in its consideration of chapter III. It had been proposed that, since recommendation 38 dealt with the subject of record keeping, such record-keeping obligations would apply throughout the procurement process. Paragraph 125 *(f)* of document A/CN.9/471/Add.4 referred to "a summary of any requests for clarification of the pre-selection documents or the request for proposals, the responses thereto, as well as a summary of any modifications of those documents". While it might not be apparent that that included keeping proper records and minutes of meetings, the secretariat believed that, for economy of language, paragraph 125 *(f)* was the most appropriate place to make the reference, bearing in mind that recommendation 38 contained a general reference to record keeping.

102. Mr. MORÁN BOVIO (Spain) said that paragraphs 71 and 72 of document A/CN.9/471/Add.4, particularly the last sentence of paragraph 72, provided an answer to the question raised by the representative of Germany.

103. *Draft recommendations 21 and 22 were adopted.*

Draft recommendation 23

104. Mr. WALLACE (United States of America) said that, since the tolls, fees and other charges referred to in recommendation 23 *(a)* normally accrued to the concessionaire, he wished to know whether such tolls, fees and charges should be low or high. Since subparagraphs *(b)* and *(d)* were related, he wondered whether or not they should be combined. Drawing attention to paragraph 77 of chapter III in document A/CN.9/471/Add.4, which stated that the contracting authority should consider carefully the relative importance of the proposed unit price for the expected output as an evaluation criterion, he proposed the addition of a new subparagraph *(g)*, which would refer to the "unit price approach" as described in paragraph 77.

105. Mr. ESTRELLA FARIA (International Trade Law Branch) said that an extensive discussion had been held about the public service nature of most privately financed infrastructure projects and the interest of the contracting authority in ensuring a certain level of quality of service. One of the criteria determining the acceptability of the proposal that the contracting authority might wish to take into account was the amount that it would have to pay for that service. Such payment did not involve income for the contracting authority but was an expense for the general public. There was therefore a public interest in including that as an evaluation criterion.

106. In an extensive debate concerning subparagraphs *(b)* and *(d)*, the representative of France had pointed that, if the contracting authority was making a payment for a service that was being provided to it, the payment did not represent a form of government support but was simply the fulfilment of a contractual obligation by the concessionaire to the benefit of the contracting authority. For reasons of clarity, it was deemed that that subject should not be dealt with in the chapter concerning government support. A distinction had therefore been made in recommendation 23 between subparagraphs *(b)* and *(d)*. Subparagraph *(d)* dealt with other forms of support, such as subsidies and guarantees, that might not be provided by the contracting authority itself but by someone else.

107. Instead of adding a new subparagraph *(g)*, perhaps additional language could be added to subparagraph *(a)*.

108. Mr. WALLACE (United States of America) said that his delegation accepted the secretariat's comments and suggestion.

109. Mr. RENGER (Germany) said that the secretariat should provide further explanation about subparagraph *(f)*, which seemed to contain a new text. He wished to know whether the words "the proposed contractual terms" referred to the contractual terms for the financing or the contractual terms for the concession.

110. Mr. ESTRELLA FARIA (International Trade Law Branch) said that there had been a debate on the subject, in which the representative of the United Kingdom and the observer for Sweden had taken part. Basically, the issue concerned the degree of responsiveness of the proposal to the contractual terms. The distinction between what was financial and what was not had not been made entirely clear, since many of the terms of the contract appeared to deal only with legal issues, such as compensation due upon termination. Perhaps the delegations that had participated in the previous year's discussion would be in a better position to enlighten the Commission.

The meeting rose at 1 p.m.

Summary record of the 699th Meeting

Tuesday, 27 June 2000, at 3 p.m.

[A/CN.9/SR.699]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 3.05 p.m.

DRAFT LEGISLATIVE GUIDE ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS *(continued)* (A/CN.9/471 and Add.1-9)

Draft recommendation 23 (continued)

1. The CHAIRMAN invited the Commission to resume consideration of the draft recommendations in the draft *Legislative Guide on Privately Financed Infrastructure Projects* (A/CN.9/471/Add.9).

2. Mr. SARIE ELDIN (Egypt) said that draft recommendation 23 *(f)* was very important and should not be changed. It should be borne in mind that the recommendation dealt with both financial and commercial aspects of proposals.

3. Ms. NIKANJAM (Islamic Republic of Iran) said that her delegation was satisfied with draft recommendation 23 as it stood, including *(f)*.

4. Ms. FOLLIOT (France) said that her delegation had several amendments to propose to draft recommendation 23. First, it was in favour of eliminating *(f)* as superfluous, since comparison of the proposals with the proposed contractual terms was implicit in the entire process of evaluating proposals. Logically, *(f)* should either be eliminated from draft recommendation 23 or added to draft recommendation 22, since it could be considered equally pertinent, or self-evident, in relation to the technical evaluation.

5. Second, draft recommendation 23 *(a)* to *(e)* could be arranged in a more logical fashion. The soundness of the proposed financial arrangements, currently in *(e)*, was in fact the topic of draft recommendation 23. The phrase should be placed first as *(a)* or in the chapeau. Under it, a distinction should be drawn between two financing modalities, which the bidder should be asked to set forth, one for the period of construction and the other for the period of operation, differentiating, for each phase, between the amount of financing that was to come from operating revenues, such as fees and charges, and the amount that was that to come from government support.

6. Ms. GIOIA (Italy) said that her delegation supported the proposal to delete *(f)* as superfluous and felt the distinction between the various sources of financing during different phases was valuable. Draft recommendation 23 *(d)*, which referred to financial support from the Government, might be worded more broadly in order to encompass other sources of public-sector financing.

7. Mr. SARIE ELDIN (Egypt) said that there was a very important rationale for the inclusion of *(f)*. Bidders often made exceptions or reservations to the proposed contract terms. Too many reservations might reduce the acceptability of their proposals and might imply longer negotiation times and additional cost to the contracting authority. It was therefore quite legitimate and often necessary, when evaluating a proposal, to take into consideration the extent to which the proposal deviated from the proposed contractual terms.

8. The distinction drawn between financing in the construction and operating phases was a valid one, but his delegation believed that the language of draft recommendation 23 sufficiently covered the situation and should remain unchanged.

9. Mr. WIWEN-NILSSON (Observer for Sweden) said that he fully supported the Egyptian position. It must be borne in mind that, whereas in conventional procurement it was easier for the contracting authority to insist on exact compliance with its terms, such insistence in infrastructure projects had proved to be nearly impossible. For one thing, lenders had an important say in the final contract terms. Draft recommendation 26 and the notes relating to the section (A/CN.9/471/Add.4, paras. 51-84) drew a distinction between negotiable and non-negotiable terms. The non-negotiable terms must, of course, be met in order for any proposal to be considered, but proposals might differ considerably in the number of negotiable deviations. The risk allocation originally proposed by the contracting authority was rarely accepted. It was therefore important for the contracting authority to be able to apply the criterion stated in *(f)*. With regard to financial soundness, he could see the value of distinguishing between different phases.

10. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the Commission, at its previous session, had decided to accommodate the full spectrum of procurement situations and allow for flexibility. At one extreme were countries that had already elaborated sophisticated contractual terms or that had legal systems requiring rejection of proposals that did not fully comply with the proposed contractual terms. But there were others that would prefer to allow the terms to evolve throughout discussions with the bidders. Some countries insisted on a minimum compliance with the original terms. The concept of non-negotiable terms appeared in draft recommendation 26, and a similar concept was expressed in draft recommendation 24, which spoke of thresholds that must be met before a proposal could be considered.

11. The extent-of-acceptance criterion was not included in draft recommendation 22 because the latter dealt only with technical evaluation, whereas draft recommendation 23 dealt with evaluation of the financial and commercial terms. Commercial terms might include provisions on liquidated damages and other issues related to allocation of risk, which were frequently left to later negotiations.

12. Mr. MARADIAGA (Honduras) noted that the meaning of "proposed contractual terms" in draft recommendation 23 *(f)* was explained by draft recommendation 20 *(c)* in the same chapter, which referred to "the contractual terms proposed by the contracting authority". In his delegation's view, *(f)* was clear and should be left as it stood.

13. Ms. FOLLIOT (France) said she believed that the notion expressed in *(f)* was implicit in the evaluation process, but if the Commission wished to make it explicit, it should also appear in draft recommendation 22, since the degree to which the proposal complied with technical specifications was also, surely, an evaluation criterion.

14. Mr. LALLIOT (France) said that his delegation wished to propose a compromise, whereby draft recommendations 22 and 23 would begin with similar wording. Draft recommendation 22 would begin: "In conformity with the proposed contractual terms, the criteria for evaluation ..."; draft recommendation 23 would begin: "In conformity with the proposed contractual terms and in order to judge the soundness of the proposed financial arrangements, the criteria for evaluation ...". Draft recommendation 23 *(e)* and *(f)* would be taken up into the chapeau. The remaining parts could be rearranged: *(c)* would be placed first, followed by *(a)*, with the addition of the words "unit price" after "fees", as proposed by the United States delegation; last would come *(b)* and *(d)* combined into one, again as proposed by the United States. Nothing would be lost, and logic and elegance would be gained.

15. Ms. MANGKLATAKUL (Thailand) said that her delegation had been convinced of the benefit of retaining *(f)*. Since no purpose appeared to be served by the French proposal, draft recommendation 23 should remain as it stood.

16. Mr. KASHIWAGI (Japan) said that his delegation agreed with the positions expressed by the representative of Egypt and the secretariat.

17. Mr. PINZÓN SÁNCHEZ (Colombia) said he agreed with the suggestion of Italy that draft recommendation 23 *(d)* should be more broadly worded, so that it referred to financial support not just from the Government but from other public-sector sources.

18. Mr. ESTRELLA FARIA (International Trade Law Branch) pointed out that the term "Government" had been broadly defined in the notes (A/CN.9/471/Add.1, para. 16).

19. Mr. LALLIOT (France) asked whether the inclusion of the clause expressed in draft recommendation 23 *(f)* but nowhere in draft recommendation 22 meant that in evaluating technical proposals conformity to specifications was not a concern.

20. Mr. ESTRELLA FARIA (International Trade Law Branch) said that *(f)* was worded to refer back to the contractual terms mentioned in draft recommendation 20 *(c)*, whereas the whole of draft recommendation 22 referred back to the project specifications and performance indicators mentioned in draft recommendation 20 *(b)*. That meant that the wording of an analogous phrase in draft recommendation 22 would have to be somewhat different. He did not believe, however, that such a phrase would be contrary to the policy worked out by the Commission.

21. The CHAIRMAN said that, as he understood it, the intent of draft recommendation 23 *(f)* was to draw particular attention to the need for Governments to consider the extent of compliance with the proposed contractual terms relating to commercial aspects when awarding contracts.

22. Mr. WALLACE (United States of America) said that draft recommendations 23 and 24 taken together provided a combination of minimum conformity requirements, or "thresholds", with respect to both technical and commercial aspects, while allowing for more flexibility in proposed contractual terms than was usual in straight procurement transactions. His delegation thought the right balance had been struck.

23. The CHAIRMAN suggested that draft recommendation 23 should be adopted as drafted, because the concerns expressed were dealt with in subsequent paragraphs.

24. *Draft recommendation 23 was adopted.*

Draft recommendation 24

25. Mr. WIWEN-NILSSON (Observer for Sweden) said that, for the sake of consistency, the word "financial" should be inserted in the series "technical and commercial aspects".

26. Mr. ESTRELLA FARIA (International Trade Law Branch), responding to a question from the Chairman, said that he did not recall any policy decision by the Commission not to include financial aspects.

27. *Draft recommendation 24, as orally amended, was adopted.*

Draft recommendation 25

28. *Draft recommendation 25 was adopted.*

Draft recommendations 26 and 27

29. Mr. WIWEN-NILSSON (Observer for Sweden) pointed out that the heading of the section in the recommendations, "Final negotiations", did not coincide with the heading of the corresponding section in the notes (A/CN.9/471/Add.4, sect. C.6), which read "Final negotiations and project award".

30. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the heading in the notes should be shortened to correspond to the heading in the recommendations, since project awards were dealt with in a later section.

31. The CHAIRMAN said he took it that the Commission wished to make the change suggested by the secretariat.

32. *It was so decided.*

33. Mr. SARIE ELDIN (Egypt) asked whether the secretariat or the expert committee had considered the very common situation in which, after selection of the concessionaire but before the financial closing, lenders called for changes in the agreements. It would be very helpful if some advice could be given to Governments on how to deal with the problem.

34. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the matter had been discussed by the Commission and in consultations with experts. The problem was dealt with briefly in paragraph 70 of the notes on chapter III (A/CN.9/471/Add.4), where it was suggested that the contracting authority should require the final proposals to show that the bidder's main lenders were comfortable with the commercial terms and allocation of risks. The last sentence of draft recommendation 26 suggested that the final request for proposals should identify certain terms as non-negotiable. The United Kingdom procurement guidelines for privately financed infrastructure projects contained a similar recommendation. What a Government could or should do if lenders nonetheless insisted on reopening certain issues would depend on the country's general policy.

35. The CHAIRMAN said that one aspect of the question was whether the last sentence of draft recommendation 26 was meant to apply not only to the successful bidder but also to third parties, such as the lenders.

36. Mr. NDJOG NYOBE (Cameroon) inquired how the contracting authority was supposed to respond, if two bidders both achieved the best rating.

37. Mr. WALLACE (United States of America), replying to the query raised by the Chairman, referred to the statement in paragraph 83 of the notes (A/CN.9/471/Add.4) that the final negotiations should satisfy the "reasonable requirements" of the selected bidder's lenders. Although the final negotiations had not been discussed, as far as he could recall, there had been some discussion of direct agreements between lenders and contracting authorities. The point raised by the representative of Egypt had indeed been discussed, at a meeting of experts. One positive feature of the draft Guide, which sought to change behaviour rather than merely reporting on it, was to bring to the attention of contracting authorities the pressure which might be exerted on bidders by their lenders, and the need to persuade lenders to commit themselves at an earlier stage. That point was covered in paragraphs 70 and 83 of the notes. However, direct deals between lenders and Governments had not been specifically addressed in recommendation 26.

38. Mr. MYERS (Observer for the International Bar Association) recalled that the matter had been fully discussed at a meeting of experts, but the industry had not yet succeeded in solving the problem, nor could it be solved through the recommendations in the draft Guide. The difficulty was that lenders did not pay attention to projects until they were sure that their team would win the tender; at that point, they often stated that they would not finance the project unless certain particulars were changed. There was a need to tie lenders down at an earlier stage in the project. The only proposal to that effect was the one referred to by the secretariat, as contained in the notes.

39. Mr. SARIE ELDIN (Egypt) said that recommendation 26 did not meet the concerns of his delegation. His country and others, such as Mexico and Indonesia, were familiar with the situation in which a lender would enter a deal after extensive negotiations, when the project documents had already been signed. Some issues, such as assignment and stepping-in rights, could be covered by direct agreement. On other issues, such as risk allocation, lenders might request an amendment in the actual project documents. The Commission should consider making a recommendation to contracting authorities advising how that situation should be dealt with in a legal sense. Project companies could find themselves in difficulty; being reluctant to lose a contract, they would sometimes leave it to lenders to pursue the negotiations. The Commission could perhaps stipulate that lenders should not be allowed to renegotiate matters which could not be renegotiated by project companies or bidders.

40. The CHAIRMAN agreed that the issue was an important one which should be drawn to the attention of contracting authorities. He asked whether the problem should be discussed in the notes, or whether the Commission wished to formulate an additional recommendation.

41. Mr. WALLACE (United States of America) pointed out that the Commission was preparing a legislative guide, not a manual on how to deal with banks. The issue would have to be confined to the notes, where it was already discussed, in paragraph 83 of document A/CN.9/471/Add.4. Governments should take a stronger line, stating their requirements clearly in the bidding documents and then holding the bidders to them.

42. Mr. WIWEN-NILSSON (Observer for Sweden) agreed. The Commission should be careful not to include in the recommendations anything which would discourage private-sector financing.

43. Mr. ESTRELLA FARIA (International Trade Law Branch), referring to the question raised by the representative of Cameroon, said that it had not previously been discussed by the Commission.

44. Mr. DARCY (United Kingdom) said that he was familiar with the situation described by the representative of Cameroon. Some countries, including his own, occasionally tried to bring two bidders forward to final negotiations, in order to intensify the competition. That should perhaps be reflected in the language of recommendation 26, by referring to "bidders" in the plural.

45. Mr. WALLACE (United States of America) thought that it would be dangerous to refer to "bidders", which could signify a plurality of bidders, not just two. Competition was certainly a good thing, but it would be better to make reference in the notes to the situation described by the representative of Cameroon.

46. The CHAIRMAN observed that it was a situation which sometimes occurred in high-value projects.

47. Ms. NIKANJAM (Islamic Republic of Iran) favoured the solution proposed by the representative of the United Kingdom.

48. Mr. DARCY (United Kingdom) withdrew his proposal. He agreed with the representative of the United States that it might be hazardous to refer in the recommendation to "bidders" in the plural. However, reference could be made in the notes to the fact that in some situations, it was necessary to take more than one bidder through to final negotiations.

49. *Draft recommendations 26 and 27 were adopted.*

Draft recommendations 28 and 29

50. Mr. DARCY (United Kingdom) proposed amendments to recommendations 28 and 29. The title "Direct negotiations" was confusing and did not adequately describe the subject. For the sake of clarity, he suggested replacing it by "Contract award without competition". He was not entirely happy but was prepared to accept recommendation 28 *(e)* and *(f)*. With regard to recommendation 29, he proposed adding measures to ensure transparency, which was particularly important where there was no competitive procedure. Several of the existing provisions, especially *(c)*, would be irrelevant if there was only one bidder. He therefore suggested deleting *(b)*, *(c)* and *(e)*, and moving *(d)* to a later point in the draft Guide, since it was a general consideration which applied in all selection and award procedures. Recommendation 29 *(f)* should become *(b)* and should read: "The offer should be evaluated according to the criteria for the evaluation of proposals established by the contracting authority". A new *(c)*, intended to enhance transparency, would read: "Public notices of contract awards should disclose the specific circumstances and reasons for the award without competition". If those proposals were accepted, appropriate amendments should be made to the notes.

51. Mr. WALLACE (United States of America) welcomed those proposals but pointed out that they would alter the section as it stood, which contemplated the possibility of more than one bidder. For example, paragraph 89 *(d)* of the notes (A/CN.9/471/Add.4) referred to "cases where there is only one source capable of providing the required service", namely, a sole source of procurement. The proposed changes would also affect recommendation 35, concerning direct negotiations with the author of an unsolicited proposal, which would also contemplate more than one bidder.

52. Ms. NIKANJAM (Islamic Republic of Iran) said that her only concern with regard to the United Kingdom proposals was the requirement to disclose, through public notices, the circumstances in which an award had been made. What would happen if those circumstances had to be kept confidential for reasons of security or the national interest?

53. Mr. LALLIOT (France) supported the United Kingdom proposal. The proposed amendment to the title of recommendation 28 would dispel its ambiguity. The text of the recommendation must be altered in consequence, for the sake of consistency. The proposed amendments to recommendation 29, especially the new *(c)*, would provide for greater transparency in the award of contracts.

54. Mr. ESTRELLA FARIA (International Trade Law Branch), referring to the point raised by the Iranian representative, said that no requirement concerning security had previously been included in recommendation 29. If the Commission so wished, an appropriate reference such as that in recommendation 28, subparagraph *(c)*, could be included in recommendation 29. Concerning the question of a plurality of bidders, which would enhance competition, that situation had in fact been envisaged previously by the Commission in recommendation 29. An appropriate reference could be made in the notes to the desirability of ensuring a minimum level of competition if negotiations involved more than one party.

55. Mr. RENGER (Germany) said there was no need to revert to a previous decision by the Commission. It had been made clear, in paragraph 128 of the previous year's report, that the title "Direct negotiations" should be retained.

The meeting was suspended at 4.25 p.m. and resumed at 4.55 p.m.

56. The CHAIRMAN asked whether the Commission believed that the title "Direct negotiations" reflected a firm UNCITRAL decision.

57. Mr. REICHEL (Observer for the World Bank) said that he supported the United Kingdom proposal in the interests of clarity and transparency.

58. Mr. KASHIWAGI (Japan) also expressed support for the United Kingdom proposal.

59. The CHAIRMAN said that he took it that the Commission wished to adopt the United Kingdom proposal regarding the title of the section comprising recommendations 28 and 29, and similarly to replace the term "direct negotiations" wherever it occurred in the text of those recommendations.

60. *It was so decided.*

61. Mr. MOHAMMED (Nigeria), referring to the issue of confidentiality raised by the Iranian delegation, said that in the real world it was often not possible to provide the required information, or else the requirement was not respected. He therefore agreed with the Iranian delegation that the matter was best not included in the draft.

62. Mr. WALLACE (United States of America) said that, while Nigeria's point was valid, the very first clause of recommendation 28, to the effect that the law should set forth the exceptional circumstances, constituted both a general record-keeping requirement and indicated that good procurement practice under the UNCITRAL Model Procurement Law required any movement from a competitive to a less competitive or non-competitive method to be justified, along the lines suggested in the United Kingdom proposal. Something had to be said, including at least a reference to approval by a higher authority. Otherwise the normal competitive method could be abandoned altogether without explanation.

63. Mr. WIWEN-NILSSON (Observer for Sweden) said that perhaps the Iranian concern could be addressed under the exception made in recommendation 28 *(c)* for reasons of national defence or national security.

64. The CHAIRMAN said that a way had to be found, however, to ensure that the principle underlying recommendations 28 and 29 would not be undone by a simple declaration that a particular project affected national security.

65. Ms. FOLLIOT (France) said that two issues were involved. The confidentiality of the negotiations themselves between the two future contracting parties had to be distinguished from the question of recourse to a non-competitive contract award procedure, requiring a subsequent public notice. Nothing had been stipulated, however, about the degree of specificity of that public notice, and therefore a Government could simply invoke one of the exceptions in recommendation 28, for instance, the exception in *(c)*, for reasons of national defence or national security.

66. The CHAIRMAN agreed that the issue was not the confidentiality of the negotiations but rather whether there should be any exceptions to the proposed requirement for public notice and justification.

67. Ms. NIKANJAM (Islamic Republic of Iran) said that her concern had been to have included among the exceptions in recommendation 28 situations requiring confidentiality. She agreed that *(c)* concerning reasons of national defence or national security would, as suggested, be a good place for such language.

68. Mr. ESTRELLA FARIA (International Trade Law Branch) suggested that the Iranian concern could be accommodated by amending the proposed United Kingdom formulation of the new *(c)* in recommendation 29, so that it would read: "Except for the situations provided for in recommendation 28 *(c)*, public notices of contract awards should disclose the specific circumstances and reasons for the award without competition." Moreover, the words "of the contract" or "of the project" should probably also be added after the word "award".

69. Mr. DARCY (United Kingdom) accepted the secretariat's suggestion in response to the concerns of the Iranian delegation.

70. The CHAIRMAN said he took it that the Commission wished to adopt draft recommendations 28 and 29, as reformulated by the United Kingdom and the secretariat.

71. *It was so decided.*

72. *Draft recommendations 28 and 29, as orally amended, were adopted.*

Draft recommendations 30 to 34

73. *Draft recommendations 30 to 34 were adopted.*

Draft recommendation 35

74. Mr. WALLACE (United States of America) said that the reference at the end of recommendation 35 should be to recommendation 29 *(b)* to *(f)*, rather than 27 *(b)* to *(f)*; however that would have to be altered in the light of the United Kingdom amendments just adopted.

75. The kind of unsolicited proposals procedure set out in recommendation 35 contemplated the possibility of negotiations with more than one party, and the Commission must decide where to deal with the issue. It might have been appropriately included as one more exception in the list given in paragraph 89 of the notes (A/CN.9/471/Add.4), in relation to recommendation 28.

76. Mr. ESTRELLA FARIA (International Trade Law Branch) recalled that the set of provisions regarding negotiations with more than one bidder, which had originally been included in recommendation 29, had been deleted by the adoption of the United Kingdom proposal. In keeping with the principle that the draft legislative *Guide* was not intended to replace the procurement regime of the host country, which would continue to provide the framework for negotiations with more than one party, one possibility would be to have the notes describe the principles of competitiveness and transparency that should preside over negotiations more fully than recommendation 29 had done, with references to the relevant provisions of the UNCITRAL Model Procurement Law. That would obviate the need to include more recommendations on the matter or to reproduce the entire procurement regime in chapter III.

77. Specifically, paragraphs 90 to 96 of the notes (A/CN.9/471/Add.4)—formerly relating to recommendations 28 and 29—should be shifted to section E, *Unsolicited proposals*. There should be a general statement to the effect that, whenever the law authorized the contracting authority to award a contract without competition, either under the circumstances referred to in recommendation 28 or in the case of unsolicited proposals, measures to enhance transparency should be followed. The current text of paragraphs 90 to 96 would then follow.

78. The CHAIRMAN said he took it that the Commission agreed that the secretariat should be entrusted to make the changes indicated.

79. *It was so decided.*

80. *Draft recommendation 35 was adopted.*

Draft recommendations 36 and 37

81. *Draft recommendations 36 and 37 were adopted.*

Draft recommendation 38

82. Mr. WIWEN-NILSSON (Observer for Sweden) suggested that the confidentiality provision originally in recommendation 29 *(d)*, which the Commission had decided to place later in the draft, should be addressed in the context of recommendation 38.

83. Ms. FOLLIOT (France), concurring, said that any recording of key information raised the question of access to that information and the extent to which it should be divulged.

84. The CHAIRMAN said that there were two issues: the fact that recommendation 38 did not set out the circumstances under which the public could or could not have access to such information; and the question whether the law should set out those circumstances.

85. Mr. ESTRELLA FARIA (International Trade Law Branch) said he himself believed that the confidentiality provision should go before recommendation 36, because the obligation of confidentiality was one that applied even before the end of the selection process. The language of former recommendation 29 *(d)* should be amended to read: "When the contracting authority is authorized to award a project without competition, any such negotiations ...". The point raised by France had been considered the previous year, and it had been thought unlikely that the Commission could arrive at a common understanding of the level of disclosure of records of the selection process in relation to the various types of requests for access. He drew attention to paragraphs 128 to 130 of the notes (A/CN.9/471/Add.4) on the question. In the draft legislative *Guide* generally, it was left to the laws of the host country to determine disclosure regulations.

86. The CHAIRMAN said that, if he heard no objection, he would take it that the Commission wished to adopt the suggestion made by the secretariat in response to the concerns expressed by the observer for Sweden.

87. Mr. WIWEN-NILSSON (Observer for Sweden) said that in the report of the Secretary-General (A/CN.9/471/Add.4), the discussion concerning disclosure of confidential information was in paragraph 129, under the heading "Record of selection and award proceedings". In order to ensure consistency between the report and the consolidated legislative recommendations (A/CN.9/471/Add.9), it might be better to place recommendation 29 *(d)*, which dealt with confidentiality, under the same heading in both documents.

88. Mr. ESTRELLA FARIA (International Trade Law Branch) said that while the points made by the observer for Sweden and the representative of France were related, they were not exactly the same. One issue was the disclosure of information contained in the record of the selection proceedings; the other was the confidentiality of negotiations between the contracting authority and the bidders. Those were different situations. Since the obligation of confidentiality during negotiations would apply whenever negotiations took place, the issue should be addressed before the Commission considered the outcome of the selection process. Moreover, in revising the text, the secretariat should ensure that the notes were consistent, and that references to the confidentiality of negotiations should be in keeping with later statements concerning disclosure of the record of the selection proceedings.

89. The CHAIRMAN said he took it that the Commission agreed that the text of recommendation 29 *(d)* should be placed after recommendation 38. With regard to the suggestion made by the representative of France that the legislative recommendations should address the issue of what information should be made available regarding the selection proceedings and how it should be made available, the principle adopted thus far was that the matter should be left to national legislation. If that was acceptable to the Commission, then the discussion could move on. If, however, the matter was taken up at the current meeting, that would prolong the debate.

90. Mr. MORÁN BOVIO (Spain) said that he agreed with the secretariat's approach. The matter should be left to national legislation. There was no point in introducing into the draft legislative *Guide* the possibility of modifying firmly entrenched national practices.

91. Mr. LALLIOT (France) said it was clear from paragraphs 128 to 130 of the report that the matter should remain within national jurisdiction by virtue of the principle of subsidiarity. It should be made clear in recommendation 38 also that national law should define the modalities of access to information and records. He also suggested that recommendation 36, concerning review procedures, should be placed at the end of the chapter.

92. The CHAIRMAN noted that the second sentence of recommendation 38 read, in English, "The law should set forth the public access requirements". He wondered whether there might be a discrepancy between the English and French versions.

93. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the second sentence of recommendation 38 was missing in the French version. The secretariat would rectify the omission.

94. *Draft recommendation 38, as orally amended, was adopted.*

Draft recommendation 39

95. Mr. SARIE ELDIN (Egypt) said that the title of chapter IV did not reflect the contents, which were not limited to construction and operation of infrastructure. Recommendations 41 and 42 related to the organization of the concessionaire, while recommendations 45 and 47 related to financial arrangements. He suggested that chapters IV and V should be combined, since they both dealt with the project agreement as such.

96. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the chapter had originally been entitled "Project agreement", but that title had not been retained because many of the issues dealt with in the chapter were of a statutory nature and not of a contractual nature.

97. Mr. RENGER (Germany) said that the word "might" should be changed to "should".

98. Mr. WALLACE (United States of America) said that he was not in favour of changing "might" to "should". With regard to the suggestions made by the representative of Egypt, he believed that the approach of combining chapters IV and V was too radical. As to the title of chapter IV, he agreed with the representative of Egypt that it would not be inappropriate to add "project agreement" to the title of chapter IV.

99. Mr. MORÁN BOVIO said that it might be better to reconsider the title of the chapter once the document had been completed.

100. Mr. RENGER (Germany) drew attention to the fact that the words "project agreement" also appeared in chapter V.

101. The CHAIRMAN said that there was insufficient support for combining chapters IV and V.

The meeting rose at 6 p.m.

Summary record of the 700th Meeting

Wednesday, 28 June 2000, at 10 a.m.

[A/CN.9/SR.700]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.15 a.m.

DRAFT LEGISLATIVE GUIDE ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS *(continued)* (A/CN.9/471 and Add.1-9)

1. The CHAIRMAN invited the Commission to resume consideration of the draft legislative recommendations contained in document A/CN.9/471/Add.9.

Chapter IV: Construction and Operation of Infrastructure (continued)

2. Mr. WALLACE (United States of America) reiterated his support for the Egyptian proposal that reference to the project agreement should be included in the title of chapter IV.

3. Mr. SARIE ELDIN (Egypt), replying to a comment made by the representative of Germany at the previous meeting, said that he saw no reason why the current titles of both chapter IV and chapter V could not be preceded by the words "Project Agreement:"; alternatively, chapter IV could be given a longer title incorporating several of the subheadings contained therein.

4. The CHAIRMAN pointed out that the last-mentioned suggestion would make the title rather long.

5. Mr. ONG (Singapore) suggested that the chapter title should be amended to read "Content and Implementation of the Project Agreement".

6. Mr. LALLIOT (France) said that while he had no preference as to the chapter title, he strongly objected to the Egyptian proposal to combine chapters IV and V.

7. Mr. RENGER (Germany), Mr. MARADIAGA (Honduras) and Mr. AL-SAIDI (Observer for Kuwait) endorsed the proposal made by the representative of Singapore.

8. Mr. SARIE ELDIN (Egypt) said that, upon reflection, he too was prepared to support that proposal.

9. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the secretariat had deliberately chosen a neutral wording for the title because there had been considerable disagreement on whether the issues covered in the chapter should be addressed through a statutory or case law approach. For that reason, the Commission might wish to postpone a decision on the title until it had considered all the recommendations contained in chapters IV and V.

10. The CHAIRMAN said that if there was no objection, he would take it that the Commission wished to proceed along those lines.

11. *It was so decided.*

Draft recommendation 39 (continued)

12. Mr. MORENO RUFFINELLI (Paraguay) and Mr. MARADIAGA (Honduras) proposed minor drafting changes in the Spanish text of the recommendation.

13. Mr. WIWEN-NILSSON (Observer for Sweden) said that he had spoken in error at the previous meeting: he had meant to propose that the reference to recommendations 39 to 65 should be amended to "recommendations 40 to 67".

14. Mr. RENGER (Germany) asked the secretariat to explain the basis on which those recommendations had been selected.

15. Mr. ESTRELLA FARIA (International Trade Law Branch) said that in fact, a reference to recommendation 39 would be redundant and that recommendation 66 had been inadvertently omitted from the series. However, because recommendation 67

had been the source of considerable conflict at the previous session of the Commission, it had been decided that the issues raised therein should be left to the discretion of the parties concerned. Thus, the text should read "recommendations 40 to 66".

16. Mr. WIWEN-NILSSON (Observer for Sweden) pointed out that in the absence of that explanation, the reader might wonder why recommendation 67 had not been mentioned; moreover, there might be other recommendations in the series on which there was not full consensus. Thus, it would be best to mention recommendations 40 to 67.

17. The CHAIRMAN suggested that the Commission should complete its consideration of recommendations 40 to 67 before finalizing recommendation 39.

18. Mr. WALLACE (United States of America) said that such a procedure was unnecessary; the use of the words "might" and "may" rather than "should" ensured flexibility for the parties, and the Commission should simply adopt the Swedish proposal.

19. Mr. SARIE ELDIN (Egypt) said that since some recommendations in the series used the word "should" while others, less dogmatic, used "may", the best solution might be to delete the entire second half of the recommendation, which would thus end with the word "agreement".

20. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the reference to specific recommendations had been included at the suggestion of outside experts; the Commission was free to delete it.

21. Ms. LI LING (China) said that she would prefer to keep the list of recommendations, which provided useful guidance on the issues to be covered in the project agreement. She therefore supported the Swedish proposal.

22. Mr. RENGER (Germany) and Mr. KASHIWAGI (Japan) said that they agreed with the representative of China.

23. The CHAIRMAN said that there seemed to be general agreement on the Swedish proposal.

24. *Draft recommendation 39, as orally amended, was adopted.*

Draft recommendation 40

25. Mr. SARIE ELDIN (Egypt) asked whether the words "Unless otherwise provided" were intended to mean "provided by law" or "agreed to by the parties". The English was ambiguous whereas the Arabic clearly suggested the former interpretation.

26. Mr. ESTRELLA FARIA (International Trade Law Branch) said that after extensive discussion at the previous session of the Commission, the words "Unless otherwise provided" had been proposed by the observer for Canada. While the ambiguity of those words was deliberate, the Arabic translators at the United Nations Office at Vienna had warned the secretariat that it might be difficult to retain that neutrality in the Arabic text.

27. The CHAIRMAN said that unless the Arabic-speaking participants could suggest an alternative wording, he saw no solution to the problem. He would therefore take it that the Commission wished to adopt recommendation 40 in its current form.

28. *Draft recommendation 40 was adopted.*

Draft recommendations 41 and 42

29. *Draft recommendations 41 and 42 were adopted.*

Draft recommendation 43

30. Mr. ESTRELLA FARIA (International Trade Law Branch) recalled that the recommendation had originally contained more detailed provision on Government responsibility for providing the land, and there had been an extensive discussion as to whether that obligation would be carried out by compulsory acquisition or by other means. It had eventually been decided, in view of the many different administrative arrangements existing in the various host countries, that it would not be feasible to attempt to formulate a recommendation that would be applicable to all legal systems. The notes discussed the need for acquisition of the land, but there was no specific recommendation.

31. Whereas draft recommendation 44 dealt only with easements and not with compulsory purchase, which was discussed in the notes, recommendation 43 addressed the different issue of clarifying who owned what, once the land had been acquired and the project built.

32. Ms. FOLLIOT (France) suggested that the words "*de l'Etat*" in the French version of the text were too restrictive and should be replaced by the words "*des autorités contractantes*".

33. Mr. MARADIAGA (Honduras) pointed out that recommendation 43 referred in two places to termination of the project agreement. He was not sure that the word "*rescindirse*" was the appropriate word to use in the Spanish version of the text, and he requested clarification.

34. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the term used in the Spanish version did not correspond exactly to the word used in the English version, which had a broader meaning. However, during the final revision of the text, the Commission would consult colleagues from the Spanish Translation Service to ensure that the translation was correct.

35. Mr. WIWEN-NILSSON (Observer for Sweden) suggested that the expression "*propriété publique*" should be used in the French text.

36. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the phrase in the French version would be amended to read "*propriété publique*".

37. *Draft recommendation 43, as orally amended, was adopted.*

Draft recommendation 44

38. Mr. WALLACE (United States of America), referring to the heading "The project site and easements", said that recommendation 44 dealt only with easements, although assistance with the acquisition of the site was probably a sine qua non of the project in many cases. Although it might not be required in every case, the text should refer to the acquisition of site and easements. The word "should" should be changed to "may", and the text amended to read "The contracting authority may have the authority to assist the concessionaire in the acquisition of the site and easements ...". The text would then correspond to the heading.

39. Mr. ESTRELLA FARIA (International Trade Law Branch) noted that if the Commission agreed to the United States proposal, a minor amendment would have to be made to recommendation 44. The order of recommendations 43 and 44 should be reversed, and the notes rearranged.

40. Mr. MAZINI (Observer for Morocco) wondered whether it was appropriate to refer to "acquisition" of easements. It would seem more appropriate to refer to benefiting from easements, rather than acquiring them. He requested the secretariat to find a more appropriate term.

41. Ms. GAVRILESCU (Romania) asked whether the United States delegation wanted to modify the wording of recommendation 44. She agreed with the Moroccan delegation that easements were granted by the host country rather than acquired. If the Commission was going to change the main thrust of the text, it could open a very protracted discussion.

42. Ms. NIKANJAM (Islamic Republic of Iran) said she would not object to retaining the present order of the recommendations. The rights to easement, for her delegation, derived from property rights. The question of whether the assets involved were public or private property should be discussed first, and then the exceptional cases of rights to easement should follow.

43. Ms. FOLLIOT (France) said that although the use of the word "*servitudes*" in the French version could lead to confusion, it had been chosen by the secretariat and the Commission. As its use in the text was defined very precisely in note 31 (in document A/CN.9/471/Add.5) there did not seem to be any need for further concern.

44. Mr. SARIE ELDIN (Egypt) supported the United States proposal. It seemed straightforward that the project agreement should refer to acquisition of the site, which was perhaps more important than the easements. He would accept any rearrangement found necessary by the secretariat.

45. Mr. DEWAST (European Lawyers Union) suggested that the words "*droits d'accès*" could be used in the French text instead of "*servitudes*" as a translation of "easements".

46. Ms. GAVRILESCU (Romania) said that her delegation could accept the term "*droits d'accès*", but not the idea of acquiring the site, which would run counter to the Romanian constitution.

47. Mr. MAZINI (Observer for Morocco) suggested the wording "The contracting authority should assist the concessionaire in benefiting from the rules of easements". Easement implied more than the right of access; it also included the right of transit, the right of temporary use and a number of other legal concepts in the Moroccan legal system. He therefore preferred to retain the word "*servitudes*".

48. It did not seem necessary to refer to acquisition of the site. The concessionaire could purchase the site in the usual way, or it could be assisted by the State, which would amount to expropriation. Insisting on adding such a reference would open another debate.

49. Mr. LALLIOT (France), referring to the Moroccan proposal, said that the sole purpose of the second sentence was to explain the term "easements", which had a very precise legal meaning. The meaning of the French term "*servitudes*" had a much broader meaning than "*droits d'accès*".

50. In response to the concerns expressed by the United States and Egyptian delegations, he would prefer a reference to acquisition of the land, in the first sentence, rather than acquisition of the site. The sentence could begin "The contracting authority should assist the concessionaire in the purchase of the land needed ...", which would make a complete and well-balanced recommendation, without going into the difficult and sensitive subject of expropriation rights. The first sentence would refer to acquisition of the land, and the second would refer to rights associated with acquisition, which were referred to as "easements" in some legal systems. The recommendation would also then be consistent with the notes.

51. Mr. WIWEN-NILSSON (Observer for Sweden) said that the two sentences did not deal with the same subject. The second sentence related only to requirements for the construction phase, and hence had a more narrow meaning than the first sentence.

52. The Commission should respect the fact that some countries had difficulty with the concessionaire's acquiring ownership of the land. Instead of referring to the right to acquire the site, the first sentence could be amended to read: "... in the acquisition of easements and other rights to land ..." without specifying whether it was ownership, leasing or other rights, so that it would be appropriate for the different legal systems.

53. Mr. MARADIAGA (Honduras) said that he understood that recommendation 44 was dealing with easements rather than property rights. On another point, he pointed out that the end of the second sentence should be amended to read: "construction, operation and maintenance of the facility".

54. Ms. GAVRILESCU (Romania) said that if a compromise could not be found, Romania would not be able to accept the legislative guide. She suggested that assistance with acquisition or leasing of the site could be referred to as options rather than obligations, to make text more acceptable. However, the best solution might be to leave the original text of the recommendation, without any additions or deletions. It was, after all, based on the drafting decisions taken at a previous session of the Commission.

55. Mr. KASHIWAGI (Japan) said that it was very important for the construction company and the operating company to receive assistance in acquiring the site and easements, and such provision was often included in construction contracts. He insisted that there should be some reference to government assistance in the recommendation.

56. The two sentences were quite different. The first said that the contracting authority "should" assist, and the second said that the law "might" empower the concessionaire. He shared the views of the observer for Sweden, who had offered a compromise solution.

57. Mr. ESTRELLA FARIA (International Trade Law Branch) said that it was clear from the notes on chapter IV, in paragraphs 23 to 25 of document A/CN.9/471/Add.5, that in some legal systems all the assets used in public service were public property and remained as such. In other systems there could be different categories of assets, some being the property of the concessionaire, and under other systems all assets might be private property. No single solution was imposed by the guide.

58. With regard to the French proposal, and the concerns expressed by the Romanian delegation, if the contracting authority provided assistance with acquiring the site, the question arose of who was the owner. Under many legal systems, any expropriated property became public property. The contracting authority was required only to do its best to make the site available to the concessionaire so that the project could be implemented. The question of ownership was left to the law of the host country.

59. Mr. ONG (Singapore) said that recommendation 44 should be read in conjunction with paragraphs 31 and 32 of document A/CN.9/471/Add.5. Recommendation 44 referred to two ways in which a concessionaire could be assisted in acquiring easements; for the sake of clarity, the words "another solution might be for" could be added at the beginning of the second sentence.

60. Mr. DARCY (United Kingdom) said that his delegation supported recommendation 44, and agreed with Honduras that it made no reference to the ownership of property. It was important that the concessionaire should have the necessary rights to be able to operate, construct and maintain a facility. Rather than referring to "easements", it might be better to use the words "the necessary rights".

The meeting was suspended at 11.40 a.m. and resumed at 12.15 p.m.

61. Mr. SARIE ELDIN (Egypt) said his delegation felt that it was very important to add a reference to the project site, which had nothing to do with the question of ownership. The meaning of the word "easements" was clear in the English and Arabic texts.

62. Mr. MAZINI (Observer for Morocco) said that his delegation endorsed the explanation that recommendation 44 did not incorporate the idea of any transfer of property, and could support the recommendation if it referred only to easements. The word "acquisition" in the first sentence should be changed.

63. Mr. PINZÓN SÁNCHEZ (Colombia) said that his delegation agreed that recommendation 44 did not refer to property rights. It had no difficulty with the use of the word "easements", the meaning of which was clarified in the second sentence.

64. Mr. LALLIOT (France) proposed that in the first sentence, the words "*à acquérir les servitudes*" should be changed to "*à disposer des droits*", as a more neutral formulation.

65. Ms. GAVRILESCU (Romania) said that her delegation supported that proposal.

66. Mr. ESTRELLA FARIA (International Trade Law Branch) suggested that the first sentence should read: "The contracting authority should assist the concessionaire in obtaining rights related to the project site".

67. Mr. MARADIAGA (Honduras) said that his delegation supported that suggestion. He proposed that the Spanish wording should be: "*La autoridad contratante debe otorgar las facilidades para que el concesionario pueda disponer de las servidumbres necesarias ...*".

68. Mr. AL-NASSER (Observer for Saudi Arabia) said that his delegation had no difficulty with the secretariat's suggestion. However, the words "except property rights" should be added at the end of the first sentence.

69. Mr. MOHAMED (Nigeria) supported the revision proposed by the secretariat, which showed clearly that the point at issue was land and related sites. The French amendment introduced a similar clarification. On a different point, he asked why the first sentence contained the phrase "operation, construction and maintenance", whereas the second mentioned only "construction and operation"?

70. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the omission of "maintenance" in the second sentence was inadvertent and would be rectified.

71. Ms. GAVRILESCU (Romania) said that her delegation found the wording proposed by the representatives of France and Honduras and the observer for Saudi Arabia more acceptable than that of the secretariat, which seemed to depart from the position advanced by France. In the French proposal, however, "*disposer*" might be preferable to "*jouir*".

72. Mr. KASHIWAGI (Japan) expressed his delegation's strong support for the secretariat's proposal. It was clear and avoided any possible confusion over the word "easements".

73. Mr. SARIE ELDIN (Egypt), supported by Mr. WALLACE (United States of America), expressed full support for the revision proposed by the secretariat.

74. Mr. MAZINI (Observer for Morocco) expressed a preference for the wording proposed by the representatives of France and Honduras, though he believed that the Commission was largely in agreement on the substance of the recommendation. He, too, would prefer the word "*disposer*" to "*jouir*" in the French version. The use of the word "*acquérir*", which appeared in the proposal by the secretariat, might cause confusion.

75. The CHAIRMAN pointed out that the word used in English had been "obtained". Moreover, as conveyed by the interpretation, the Honduran proposal had contained the word "easements", which had seemed to be the sticking point for some delegations.

76. Mr. MAZINI (Observer for Morocco) confirmed that the use—and possible misuse—of the word "*acquérir*" constituted the main defect in the secretariat's proposal. The representative of Honduras had not, however, used the Spanish term for "easements".

77. Mr. WIWEN-NILSSON (Observer for Sweden) expressed support for the English version of the secretariat's proposal. Any remaining difficulties were surely linguistic and could be resolved. He also suggested the word "*obtenir*" as an alternative to "*acquérir*".

78. Mr. LALLIOT (France) said that any differences between his delegation's proposal and the secretariat's was linguistic and could be resolved later.

79. *Draft recommendation 44, as orally amended, was adopted.*

Draft recommendations 45-47

80. *Draft recommendations 45-47 were adopted.*

Draft recommendation 48

81. Ms. FOLLIOT (France) said that her delegation would prefer the word "*utilisé*" to the word "*détenu*", as being more neutral. Alternatively, the last phrase could be deleted in the draft recommendation, which would then end with the words "public property".

82. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the change from "*détenu*" to "*utilisé*" was substantive enough to involve a change in the other languages.

83. Mr. WALLACE (United States of America), Ms. GAVRILESCU (Romania) and Mr. WIWEN-NILSSON (Observer for Sweden) supported the deletion of the last phrase of the draft recommendation.

84. Mr. MOHAMED (Nigeria) proposed that, as in draft recommendation 44, the word "maintained" should be inserted in the first sentence.

85. Mr. MARADIAGA (Honduras) said that in the Spanish text the word "*obtener*" was preferable to the word "*recaudar*".

86. Mr. RENGER (Germany) said that in English there was a significant difference between "obtaining" and "raising" funds.

87. The CHAIRMAN said that he took it that the Commission wished to delete the final phrase of the draft recommendation. The discussion on the Honduran amendment would be resumed at the 701st meeting.

The meeting rose at 1 p.m.

Summary record of the 701st Meeting

Wednesday, 28 June 2000, at 3 p.m.

[A/CN.9/SR.701]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 3.10 p.m.

DRAFT LEGISLATIVE GUIDE ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS *(continued)* (A/CN.9/471 and Add.1-9)

Draft recommendation 48 (continued)

1. The CHAIRMAN said that the Commission had resolved all issues relating to the recommendation with the exception of whether the first line should read "raising" or "obtaining" the funds required.

2. Mr. MARADIAGA (Honduras) said that, following consultations with the representatives of Spain and Paraguay, he no longer had any objections to the use of the phrase "*recaudar los fondos*" ("raising the funds") in Spanish.

3. Mr. AL-SAIDI (Observer for Kuwait) said that he still had doubts about whether the Arabic and French translations of document A/CN.9/471/Add.9 adequately reflected the meaning of the English word "raising".

4. The CHAIRMAN said that the secretariat would look into the matter.

5. *Draft recommendation 48 was adopted.*

Draft recommendation 49

6. Mr. WALLACE (United States of America) suggested that the second sentence should be deleted. The first and second sentences both dealt with whether the contracting authority should give its consent to an assignment of the concession. While the second sentence stated that the concession should not be assigned without the consent of the contracting authority, the first sentence left open the possibility that such consent might not be required at all. It therefore reflected the type of flexibility that might be needed in the types of projects under consideration. The second sentence appeared to be too categorical in the light of paragraphs 61 to 63 of the report of the Secretary-General (A/CN.9/471/Add.5).

7. The CHAIRMAN said that the suggestion made by the United States representative raised a policy issue. He recalled that at the conclusion of its previous session, the Commission had decided that there should be no interference with policies which it had already established. He invited the representative of the secretariat to comment on whether the United States proposal adequately reflected the Commission's previous decision.

8. Mr. ESTRELLA FARIA (International Trade Law Branch) said that there had been an extensive debate at the previous session as to the link between so-called direct agreements between the contracting authority and the lenders and the other principle reflected in the second sentence of the recommendation, to which the United States representative had referred. The final formulation had been arrived at following negotiations held between the secretariat and outside experts at the request of the Commission. The idea was that the second sentence constituted a general principle and the first sentence an exception thereto. The first sentence described a situation where an exception would be made by means of a direct agreement between the contracting authority and the lenders allowing for "step-in" rights or the transfer of the concession to a third party. Although strong views had also been expressed against the general principle as reflected in the second sentence, the prevailing view had been that the principle was one that was common to many legal systems, since the concessionaire was selected because of its ability to carry out the project and it should not be free to transfer that responsibility to third parties. In the course of the discussion it had been agreed to combine the two ideas, but perhaps greater clarity would be achieved if they were reversed.

9. The CHAIRMAN said that, as explained by the secretariat, the decision reached by the Commission after much debate was the reverse of the position put forward by the United States delegation. The secretariat was now proposing that the principle to be recommended was that concessionaires should not be free to assign the concession to a third party without the consent of the contracting authority except in the circumstances set out in the first sentence.

10. Mr. SARIE ELDIN (Egypt) said that he was grateful to the secretariat for the clarification provided and had intended to make the same proposal.

11. Ms. GAVRILESCU (Romania) and Mr. MARADIAGA (Honduras) said that they, too, supported the secretariat's proposal.

12. *Draft recommendation 49, as orally amended, was adopted.*

Draft recommendation 50

13. Ms. GAVRILESCU (Romania) requested clarification of the term "*intérêt majoritaire*" (majority interest).

14. The CHAIRMAN said that the word "majority" did not appear in the English version.

15. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the term used in English was "controlling interest". In the case of a joint stock corporation, that would mean the person or entity controlling the majority of the voting shares in the capital of that corporation. The French delegation appeared to be satisfied that the term used in the French version adequately reflected the original English text.

16. Mr. JACOBSON (United States of America) suggested that the phrase "under specified circumstances" should be added at the end of the recommendation. That would reflect the discussion in paragraphs 63 to 68 of document A/CN.9/471/Add.5, which made it clear that restrictions on the transfer of the equity interest

were limited in various ways and might not be appropriate in many cases.

17. The CHAIRMAN said that the United States proposal would significantly change the sense of the recommendation as drafted by the secretariat. Under the United States proposal, transfer of a controlling interest in the concessionaire would be allowed except under certain specified circumstances. He invited the representative of the secretariat to comment on whether that proposal adequately reflected the decision reached by the Commission at its previous session.

18. Mr. ESTRELLA FARIA (International Trade Law Branch) said that in its original draft the secretariat had presented a more detailed provision, spelling out the circumstances under which it might be reasonable for the contracting authority to require that any transfer should be subject to its prior consent. A full discussion of the matter was to be found in paragraphs 64 to 66 of document A/CN.9/471/Add.5. It should be noted that recommendation 50 was one of the few recommendations in chapter IV that used the word "may"; it was therefore not as strong as the other recommendations in the chapter. The point made by the United States representative was implicit in the wording of the recommendation. Nevertheless, should the United States proposal be adopted, it would not be inconsistent with the overall sense of the Commission when it had last discussed the issue.

19. Mr. WIWEN-NILSSON (Observer for Sweden) suggested that the French version might be preferable to the English one, as the French text omitted the words "in the capital of".

20. Mr. SARIE ELDIN (Egypt) said that, while it was legitimate to underscore the principle of the prior approval of the contracting authority, the concern expressed by the United States delegation might be allayed by adding the words "unless agreed otherwise" at the end of the recommendation.

21. Mr. JACOBSON (United States of America) said that he had no objection to the Egyptian proposal.

22. The CHAIRMAN said that, if he heard no objections, he would take it that the Commission wished to add the words "under specified circumstances, unless agreed otherwise" at the end of the recommendation and to delete the phrase "in the capital of".

23. *Draft recommendation 50, as orally amended, was adopted.*

Draft recommendation 51

24. *Draft recommendation 51 was adopted.*

Draft recommendation 52

25. Mr. MAZINI (Observer for Morocco) said that the Arabic translation of the recommendation reflected the exact opposite of the principle that the Commission was discussing. He suggested that some drafting changes should be made to the text: *(a)* should read "... so as to meet the evolving actual demand for the service"; *(b)* should read "... under conditions guaranteeing equal access to all users"; and *(d)* should read "The access of other service providers to the interconnection to any public infrastructure network operated by the concessionaire under objective, transparent and non-discriminatory conditions."

26. The CHAIRMAN asked whether the Commission as a whole was satisfied with the text as drafted.

27. Ms. NIKANJAM (Islamic Republic of Iran), referring to *(a)*, said that it was unclear what the phrase "actual demand for the service" meant.

28. Mr. MORÁN BOVIO (Spain) and Mr. RENGER (Germany) said that the text as drafted adequately reflected the discussion at the previous session.

29. The CHAIRMAN said that the text would remain as drafted.

30. *Draft recommendation 52 was adopted.*

Draft recommendations 53 to 55

31. *Draft recommendations 53 to 55 were adopted.*

Draft recommendation 56

32. Mr. JACOBSON (United States of America) suggested that the final clause should be amended to read "except in exceptional circumstances". The intention underlying the recommendation was that parties should be free to choose the applicable law.

33. The CHAIRMAN requested the representative of the secretariat to clarify whether the United States proposal related to a matter of policy.

34. Mr. ESTRELLA FARIA (International Trade Law Branch) said that, to the extent of his recollection, the understanding of the Commission at the previous session had been in line with what the United States delegation was currently suggesting. The prevailing view had been that the concessionaire should have sufficient flexibility to agree on the applicable law with its contractors. "Public policy" referred to situations in which the concessionaire was an entity of public law that would be under certain restrictions in terms of agreeing to the application of foreign law to a contract that was executed in the country with another party that was a national of that same State. In some countries that might be considered a violation of public policy. Such circumstances would, however, be exceptional.

35. Ms. LI LING (China) suggested that the words "public policy" at the end of draft recommendation 56 should be followed by the words "and law", since in her country, for example, the law provided that in certain cases Chinese law must govern such contracts.

36. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the philosophy of the Commission on the matter was reflected in paragraph 264 of the report on the work of the thirty-second session (A/54/17). At that session the Commission had recognized that freedom to choose the law governing commercial contracts was restricted in some countries under certain circumstances for reasons of compelling public policy, for example, in contracts where governmental agencies or consumers were a party. The prevailing view, however, had been that it was not desirable to restrict choice of law in general.

37. Mr. ADENSAMER (Austria) said that his delegation supported the Chinese suggestion and could not endorse the United States proposal. In Austria, as indeed throughout Europe, consumer protection was considered very important and was enshrined in law, and contracts with consumers were too common to fit under the category of "exceptional cases". China's reminder that choice of law might be restricted by law as well as public policy was useful, because the term "public policy" could be construed narrowly as meaning public order, which would not cover the situations he had mentioned.

38. Mr. GHAZIZADEH (Islamic Republic of Iran) and Mr. MORENO RUFFINELLI (Paraguay) thought that a reference to the host country's law, as suggested by the Chinese representative, would provide welcome clarification.

39. Mr. WIWEN-NILSSON (Observer for Sweden) said that the text was better as it stood. The United States wording, "except in exceptional cases", might, contrary to the proposer's intention, be interpreted even more broadly than the original language. With regard to the Chinese suggestion, it should be recalled that whatever the Commission recommended, public policy would prevail in any case. The document was intended as a guide, not as a convention, and no country would be in any way bound to follow its recommendations.

40. Ms. MANGKLATANAKUL (Thailand) and Mr. AL-NASSER (Observer for Saudi Arabia) observed that it would be better to adhere to the language already agreed upon, since public policy would prevail in any case.

41. Mr. HERRMANN (Secretary of the Commission) said that the mention of "law" would result in something of a circular argument. The draft recommendations were intended as a guide to legislators, who would be looking at their own national laws and adapting them, to the extent that they were persuaded by the guide. Existing laws restricting choice might conceivably be changed in that exercise, unless they were based on the firm policy of the Government.

42. Mr. ADENSAMER (Austria) said that he had been convinced by the reasoning of the Secretary.

43. Ms. LI LING (China) said that her delegation still felt that a reference to law would make the draft recommendation clearer.

44. The CHAIRMAN asked whether supporters of the proposed amendments were still of the same mind. Hearing no response, he took it that the Commission was willing to preserve the wording as it stood.

45. *Draft recommendation 56 was adopted.*

Draft recommendations 57 to 59

46. *Draft recommendations 57 to 59 were adopted.*

Draft recommendations 60 and 61

47. Mr. MAZINI (Morocco) suggested that draft recommendation 61 *(a)* could be made more concise by replacing the phrase "the occurrence of circumstances beyond either party's reasonable control" with the term "force majeure", which had a well-understood legal meaning.

48. Mr. HERRMANN (Secretary of the Commission) said that the equivalent in English of "force majeure" was "acts of God and acts of war", a concept which was too narrow for the purposes of draft recommendation 61 *(a)*. It was customary in the Commission's work to attempt to avoid technical terms, which might be well understood only in certain languages or legal systems, and to use instead more descriptive language, a policy that had been followed in other UNCITRAL texts, including the United Nations Sales Convention.

49. Mr. MAZINI (Observer for Morocco) said that he accepted the secretariat's explanation, but he still found the word "reasonable" modifying "control" to be ambiguous and proposed deleting it.

50. Mr. RENGER (Germany) recalled that the chapter had been discussed at length during the thirty-second session of the Commission, a debate which was summarized in paragraphs 206 to 253 of the report on the session (A/54/17). To the best of his recollection, the present wording of draft recommendation 61 faithfully reflected the outcome of that debate.

51. The CHAIRMAN noted that there did not appear to be any support for the proposal by the observer for Morocco.

52. *Draft recommendations 60 and 61 were adopted.*

Draft recommendation 62

53. Mr. AL-NASSER (Observer for Saudi Arabia) said that his delegation would prefer a simpler wording for the first part of draft recommendation 62 *(a)*. The words "it can no longer be reasonably expected that the concessionaire will be able or willing to perform its obligations" should be replaced by "the concessionaire is unable to perform its obligations".

54. Mr. ESTRELLA FARIA (International Trade Law Branch) explained that the thinking behind that wording, and indeed behind the entire section on termination of the project agreement, was that the contracting authority should be empowered to ensure that services continued to be provided. By waiting until the concessionaire had already demonstrated its inability to perform its obligations, the contracting authority might fail in its own duty to ensure continuity of services.

55. The CHAIRMAN noted that there did not appear to be any support for the proposal by the observer for Saudi Arabia.

56. *Draft recommendation 62 was adopted.*

Draft recommendation 63

57. Ms. FOLLIOT (France) pointed out that the parallel presentation of draft recommendation 62 on termination by the contracting authority and draft recommendation 63 on termination by the concessionaire, together with the broad wording of the latter, might give the misleading impression that the concessionaire had the same rights to terminate the project agreement unilaterally as the contracting authority.

58. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the point raised by the representative of France had been debated at the previous session of the Commission, and the concern had been addressed in paragraph 28 of the notes on chapter V (A/CN.9/471/Add.6), which acknowledged that some legal systems did not recognize the concessionaire's right to terminate the project agreement unilaterally, but only the right to request a third party, such as the competent court, to declare the termination of the project agreement. Draft recommendations 62 and 63 had been made parallel for the sake of clarity of style.

59. The CHAIRMAN noted that there did not appear to be any interest in rewording draft recommendation 63.

60. *Draft recommendation 63 was adopted.*

The meeting was suspended at 4.25 p.m. and resumed at 5 p.m.

Draft recommendations 64 to 67

61. *Draft recommendations 64 to 67 were adopted.*

62. The CHAIRMAN, recalling that the inclusion of the term "project agreement" in the title of chapter V had excited some doubts, invited suggestions for amending the titles of either chapter V or chapter IV.

63. Mr. MORÁN BOVIO (Spain) said that he preferred to leave the title of chapter V unaltered. It was an adequate description of the subject matter of the chapter, and if amended it might have an adverse impact on other parts of the draft guide.

64. Mr. SARIE ELDIN (Egypt) felt that the title of chapter IV was misleading, because that chapter did not deal with the various phases of construction. He referred to an earlier proposal by the representative of Singapore to amend the title to read "Content and implementation of the project agreement". That amendment could be adopted, the term "agreement" being replaced by "documents", since the construction and operation of a project might be dealt with in documents other than the agreement. The title of chapter V did not require amendment, because that chapter was concerned with specific aspects of the project agreement as such.

65. Mr. RENGER (Germany) said that he was reluctant to see the title of chapter IV altered. The notes made clear that the scope of the chapter went beyond the project agreement itself, dealing mainly with the construction works, the operation of the infrastructure and general contractual arrangements. The neutral wording of the title therefore offered advantages which should not be sacrificed.

66. Mr. SARIE ELDIN (Egypt) said that he did not agree with the German representative. In addition to the construction aspects of the project, chapter IV also dealt with the financial arrangements, assets and easements, the organization of the concessionaire, security interests, the assignment of the concession, and the transfer of a controlling interest in the project company. All those issues were quite unrelated to the construction process. The title was therefore misleading, because it dealt with only part of the subject matter of the chapter.

67. Mr. WIWEN-NILSSON (Observer for Sweden) supported the comments just made. However, since no proposals had been made for a new title, he preferred to leave the question of its wording to the secretariat.

68. Ms. LI LING (China) also took the view that the content of chapter IV did not wholly conform to its title, since many aspects of the project agreement were covered in the chapter. She suggested including the words "project agreement" in the title.

69. Mr. WALLACE (United States of America) agreed with the observer for Sweden and the representative of China. He pointed out that there was no mention of the project agreement itself in the titles of most of the chapters. Chapter IV dealt with many things. It was quite appropriate to include the words "construction and operation" in its title, but that was not inconsistent with adding a reference to the project agreement. He suggested that the title might read "Content and implementation of the project agreement" or "The project agreement: construction and operation".

70. The CHAIRMAN observed that chapter IV covered the legal rules governing the project agreement, not merely the agreement.

71. Mr. WALLACE (United States of America) proposed that the title should read "Legal framework, content and implementation of project agreement".

72. Mr. DARCY (United Kingdom) said that he was happy to leave the wording of the title to the secretariat.

73. Mr. PANG (Singapore) suggested "Execution of the infrastructure project".

74. The CHAIRMAN said that the prevailing view in the Commission was to follow the wording proposed by the representative of the United States, to include a reference to the project but not necessarily to the agreement, and to leave it to the secretariat to determine the final wording.

75. *It was so decided.*

Draft recommendation 68

76. Mr. ESTRELLA FARIA (International Trade Law Branch) explained that the new text in the notes on chapter VI (A/CN.9/471/Add.7) reflected the revision of that chapter which had taken place at the Commission's previous session. The secretariat had endeavoured in the notes to strike a balance between the interests of private parties in achieving flexibility in their arrangements and public policy concerns on the part of contracting authorities. However, it had not sought to enter into the details of dispute settlement procedures. Because little action was required from the Commission in a legislative sense, there were only four recommendations in chapter VI.

77. Ms. NIKANJAM (Islamic Republic of Iran) said that, since arbitration was only one of the methods of dispute settlement, the reference to it in draft recommendation 68 should be deleted.

78. The CHAIRMAN said the Commission should decide on its recommendations for dispute settlement, as a matter of policy.

79. Mr. SARIE ELDIN (Egypt) said that arrangements for arbitration outside the host country of the project should receive the Commission's endorsement. He suggested the insertion of the term "offshore" before "arbitration". However, judicial methods of dispute settlement should not be ruled out.

80. Mr. MORÁN BOVIO (Spain) said that the reference to arbitration was appropriate, because it was not always clear in relations between contracting authorities and concessionaires that there was a possibility of arbitration in the event of a dispute. The text of draft recommendation 68 adequately provided for all methods of dispute settlement and did not require any change.

81. The CHAIRMAN said that the issue to be decided was whether the wording of draft recommendation 68 was appropriate in a guide for legislators.

82. Mr. WALLACE (United States of America) said that the text of draft recommendation 68 did not make clear from which source the contracting authority derived its freedom to agree to various dispute settlement mechanisms. As a matter of logic, he agreed with the Iranian representative that the reference to arbitration was not necessary. However, many foreign investors would insist on the inclusion of such a reference. The Constitution of Turkey had recently been amended to provide for the possibility of arbitration, without which there could be no foreign investment in the energy sector. As the notes explained, different methods of dispute settlement were used at different stages of a project. There was also the problem of regulation: could a private arbitration override a regulatory decision? Since the notes commented very fully on alternative dispute settlement mechanisms, he felt that the deletion or retention of the words "including arbitration" in draft recommendation 68 was not a vital issue.

83. Mr. MYERS (Observer for the International Bar Association) pointed out that arbitration was the only method of adjudication which was not consensual. He did not object to the deletion or otherwise of the reference to arbitration, but he urged the Commission to keep its legislative recommendations simple and neutral, to enable States and contracting parties to choose the methods of dispute settlement which suited them best.

84. Ms. LI LING (China) said that it was preferable to delete the reference to arbitration, because it was only one of the available methods. If it was mentioned, the other methods should be mentioned too.

85. Mr. MOHAMED (Nigeria) said that it did not really matter whether or not the reference to arbitration was deleted, but that if it was he would propose amending the recommendation to read that the contracting authority should be free to agree to dispute settlement mechanisms regarded by the parties "as best suited" to the needs of the project rather than simply "as suited".

86. Mr. WIWEN-NILSSON (Observer for Sweden) said that his delegation would like to retain the explicit reference to arbitration. An arbitration clause was one of the first things most investors asked for, and they would object if Governments excluded it. If the reference to arbitration was deleted and if the notes on arbitration (A/CN.9/471/Add.7, paras. 30-38) remained neutral, it would not be clear that there was a preference in practice for arbitration.

87. Mr. ESTRELLA FARIA (International Trade Law Branch) said that the observer for the International Bar Association had rightly pointed out why arbitration had been singled out in the recommendation. The secretariat's review of national legislations and its consultations with experts, including representatives of regional investment banks and other multilateral lending agencies, had made plain that there was no legal obstacle to the use of other non-binding methods such as mediation. Possible obstacles to the freedom of the parties to agree to dispute settlement mechanisms arose only in States that made the court system the only option. Recourse to the courts was, of course, always available everywhere.

88. As to the concerns of the Swedish delegation, neither recommendations 68 and 68*bis* nor the notes on them expressed a preference for any one method, since some legal systems still did not allow arbitration. The notes described what the outlook of the various parties and the expectations and preferences of the investors were likely to be and indicated that most private investors preferred arbitration, especially international arbitration. The draft legislative *Guide* thus gave only a narrative account of the advantages and disadvantages of the various mechanisms without making a judgement as to whether a State should limit dispute settlement to the judicial system or whether it should instead be more flexible.

89. Mr. MARKUS (Observer for Switzerland) said that the secretariat's comments were an argument for leaving the text as it stood, because if in some legal systems the arbitration option was in doubt or even forbidden, and if at the same time investors strongly favoured what was obviously the only binding option, the term "including arbitration" covered the situation.

90. Mr. WIWEN-NILSSON (Observer for Sweden) said that if the reference to arbitration in recommendation 68 was deleted, he would propose that the words ", and in many cases required", should be inserted in the third sentence of paragraph 30 of the notes, between the clause "Arbitration is preferred" and the phrase "by private investors and lenders, in particular foreign ones".

91. Mr. WALLACE (United States of America) said that the Swedish suggestion was an excellent one. Paragraph 30 could in fact be expanded in a number of ways, including the incorporation of Egypt's idea regarding offshore arbitration.

92. The CHAIRMAN said he took it that the Commission wished to leave the suggested revisions of paragraph 30 of the notes to the secretariat.

93. *It was so decided.*

94. The CHAIRMAN said that the prevailing view seemed to be either that delegations favoured, or that they would not object to, deletion of the reference to arbitration in draft recommendation 68.

95. Mr. MORÁN BOVIO (Spain) noted that a number of delegations had emphasized the importance of the reference to arbitration. It would surely be a mistake not to draw attention to the dispute settlement method to which the bulk of the notes on recommendation 68 were devoted.

96. Mr. PINZÓN SÁNCHEZ (Colombia) said that he agreed with the Spanish delegation. The phrase in question was not prescriptive but simply illustrative, and the indication that arbitration was one of the options needed to be made explicit.

97. Mr. LALLIOT (France) said that he fully supported the Chairman's conclusion as to the sense of the Commission: the reference to arbitration should be deleted and the notes on recommendation 68 should be expanded as suggested by the United States and other delegations.

98. Ms. POSTELNICESCU (Romania) said that debate on the matter should not be reopened and the phrase in question should be deleted.

99. Mr. AL-NASSER (Observer for Saudi Arabia) said that he could accept either deletion or retention but that if the reference to arbitration was deleted from recommendation 68, then recommendation 68*bis* would be superfluous.

100. The CHAIRMAN said he took it that the Commission wished to delete the final phrase ", including arbitration" ; add the word "best" before the word "suited" ; and adopt recommendation 68 as amended.

101. *It was so decided.*

102. *Draft recommendation 68, as orally amended, was adopted.*

*Recommendation 68*bis

103. Mr. GHAZIZADEH (Islamic Republic of Iran) observed that in many States it was the project agreement and not the law that should indicate whether and to what extent the contracting authority might raise a plea of sovereign immunity.

104. Mr. ESTRELLA FARIA (International Trade Law Branch) recalled that the earlier discussion in the Commission regarding sovereign immunity had been reflected in its 1999 report to the General Assembly (A/54/17, para. 298). The degree of disagreement was reflected in the fact that recommendation 68*bis* had been placed within square brackets.

The meeting rose at 6 p.m.

Summary record of the 702nd Meeting

Thursday, 29 June 2000, at 10 a.m.

[A/CN.9/SR.702]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 10.05 a.m.

DRAFT LEGISLATIVE GUIDE ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS *(continued)* (A/CN.9/471/Add.1-9)

1. Mr. WALLACE (United States of America) suggested that the last three recommendations should be as brief as possible, and that recommendation 68*bis* should be deleted. It seemed to be a rather arbitrary choice of subject. Although the issue was important, it was discussed thoroughly in the notes.

2. Mr. MORÁN BOVIO (Spain) said that recommendation 68*bis* should remain in the text, because the purpose of the *Guide* was to advise both legislators and investors. It was important that the legislation should indicate to what extent the contracting authority could plead immunity. The contracting authorities and States needed to be aware of the twofold effect of preserving immunity, which maintained the State's authority but could be a deterrent to investors. That idea, which was clearly explained in the notes, should be expressed in a recommendation.

3. Ms. GAVRILESCU (Romania) supported the United States proposal to delete recommendation 68*bis*, which did not seem to be based on the Commission's policy, as expressed in the notes. The notes referred to the options available to States for settling any disputes in their relations with the concessionaire. There was emphasis on the voluntary nature of those options. There was also a reference to the conditions in which such solutions might be applied. Nothing was compulsory: the verbs were all in the conditional tense—the States "may" or "could" do something.

4. The recommendation was asking States to renounce their sovereign immunity. Perhaps the Commission should consider whether it was competent to discuss that sensitive issue. Recommendation 68 already offered States a free choice of settlement mechanisms, and recommendation 68*bis* was thus unnecessary.

5. Ms. MANGKLATANAKUL (Thailand) agreed that the recommendation should be deleted. Sovereign immunity was an executive prerogative and could not be dealt with by a legislative body. Also, the concept of sovereign immunity in relation to commercial contracts had not yet been accepted in international law. Work was continuing in the International Law Commission, and the Sixth Committee had set up a working group to look into the issue. Any reference in the Guide should be consistent with the work of those bodies, and she therefore preferred the option of deleting the recommendation.

6. In addition, although paragraphs 33 to 35 of the notes contained in document A/CN.9/471/Add.7, concerning sovereign immunity, were acceptable, she felt that paragraph 36 should be deleted.

7. Ms. FOLLIOT (France) supported the proposal to delete recommendation 68*bis*. She also proposed moving paragraph 36 of the notes to the beginning of the section on sovereign immunity, with a slight amendment at the end, to read "in which areas the contracting authorities may or may not plead sovereign immunity."

8. The CHAIRMAN said he took it that paragraph 68*bis* would be deleted.

9. *It was so decided.*

10. Mr. WIWEN-NILSSON (Observer for Sweden) found the deletion of paragraph 36 of the notes acceptable, assuming that the last two lines of paragraph 33 would also be deleted. The question of whether there would be a waiver of immunity at the executive level was a decision relating to an individual project.

11. Ms. NIKANJAM (Islamic Republic of Iran) said that the Commission needed to establish the limits between the parties to the project agreements, and not leave sovereign immunity to domestic law.

12. Mr. MORÁN BOVIO (Spain) said that paragraph 36 of the notes did not add to or detract from existing sovereign immunities, but merely requested every State to declare as clearly as possible where the boundary of sovereign immunities lay. His delegation preferred to retain the paragraph in its present form, in order to draw the attention of legislators to the issue.

13. Mr. WALLACE (United States of America) supported the French proposal concerning moving paragraph 36 to the beginning of the section.

14. In response to the views expressed by the Thai and Iranian delegations, he said that the wording of paragraph 36 did not have any implications with regard to a legislative or executive prerogative. Some Governments, according to the notes, would not be free to deal with that matter unless the issue was clarified by law. He did not think that retaining paragraph 36 would in any way prejudge consideration of the issue by the International Law Commission.

15. The CHAIRMAN pointed out that paragraph 36 did not contain the word "should" or "must". It did not even use the word "may" alone, but the expression "may wish". The language could hardly be more benign.

16. Mr. RENGER (Germany) shared the views expressed by the French and United States delegations.

17. Mr. MARADIAGA (Honduras) pointed out that the Commission was discussing notes that were intended to instruct and enlighten legislators. Sovereign immunity was a fundamental prerogative; consequently, the more explanatory the notes were, the better. For the reasons outlined by the representative of Spain, he believed the paragraph should be retained.

18. Ms. MANGKLATANAKUL (Thailand) said that paragraph 36 did not seem to add anything to the notes or have any particular effect. However, if the Commission wished to retain the paragraph, her delegation would not object.

19. Mr. WIWEN-NILSSON (Observer for Sweden) said he understood that if paragraph 36 was retained and moved ahead of

paragraph 33, the last sentence of current paragraph 33 would be deleted.

20. Ms. FOLLIOT (France) said she did not believe that the last sentence of paragraph 33 would be redundant.

21. Mr. MORÁN BOVIO (Spain), supported by Mr. KASHIWAGI (Japan), agreed that the last sentence of paragraph 33 should be retained. The text was intended to help the authorities clarify the important issue of the boundaries of sovereign immunity, for the benefit of the other contracting parties. The French proposal seemed to enjoy the support of the majority of the Commission.

22. The CHAIRMAN noted that the last sentence of paragraph 33 would be retained, and paragraph 36, as orally amended by the French delegation, would be moved to the very beginning of the section on sovereign immunity.

23. *It was so decided.*

Draft recommendation 69

24. Mr. PANG (Singapore) noted that recommendation 69 in document A/CN.9/471/Add.9 should begin with the words "The concessionaire and the project promoters", to make it consistent with document A/CN.9/471/Add.7.

25. Mr. ESTRELLA FARIA (International Trade Law Branch) confirmed that understanding.

26. The CHAIRMAN assumed that the Committee wished to adopt the draft recommendation.

27. *Draft recommendation 69, as orally amended, was adopted.*

Draft recommendation 70

28. The CHAIRMAN, in the absence of any objection, assumed that the Commission accepted the text of draft recommendation 70.

29. *Draft recommendation 70 was adopted.*

30. Mr. KASHIWAGI (Japan) said that, according to paragraphs 30 and 43 of document A/CN.9/471/Add.7, arbitration was the preferred method for settling disputes; however, he had the impression that lenders usually preferred litigation, especially in large international financing transactions.

31. Mr. WIWEN-NILSSON (Observer for Sweden) said that while it was true that lenders did not usually want to have arbitration clauses in loan agreements, they normally did request such clauses in project agreements.

32. Mr. HERRMANN (Secretary of the Commission) pointed out that banks often resorted to arbitration in order not to be exposed to a jury trial and other features of litigation. In the case of project agreements, arbitration was the preferred method.

33. Mr. SARIE ELDIN (Egypt) said that he agreed with that point, particularly in relation to projects involving local and international financing. The statement that "arbitration is preferred by private investors and lenders" therefore reflected current trends and practice.

34. Mr. WALLACE (United States of America) said that there should be a clarification in paragraph 43, since it was concerned with loan agreements.

35. The CHAIRMAN said that that issue could be left to the secretariat.

36. Mr. WIWEN-NILSSON (Observer for Sweden) said that paragraph 2 *(a)* of document A/CN.9/471/Add.7 should be amended, because it was not true that in "most" civil law countries, the project agreement was governed by administrative law. In paragraph 27, the words "or arbitrate" and "or arbitration" should be added after the words "litigate" and "litigation".

37. Mr. ESTRELLA FARIA (International Trade Law Branch) said that while it was true that not all civil law countries had the same system of separation of administrative jurisdiction, project agreements were invariably governed by administrative law.

38. Mr. MORÁN BOVIO (Spain) said that he supported the existing wording of paragraph 2 *(a)*.

39. The CHAIRMAN said that the Commission still needed to resolve the issue of whether chapter VII should be combined with chapter I.

40. Mr. WALLACE (United States of America) said that he was in favour of moving chapter VII into chapter I, because it would simplify and streamline the final product.

41. Mr. REICHEL (Observer for the World Bank) said that a reading of chapter I, part B (3), in document A/CN.9/471/Add.2, showed that the contents of chapter VII fitted perfectly under the heading "General and sector-specific legislation". Chapter VII could be streamlined and shortened. However, competition law should be added to the list in that chapter.

42. Mr. MORÁN BOVIO (Spain) said that the issue was one of aesthetics. If chapter VII was incorporated into chapter I, that chapter would be too long, and the balance of the text as a whole would be lost.

43. Mr. WIWEN-NILSSON (Observer for Sweden) said that he agreed that the issue was cosmetic; the Commission should not rewrite the text.

44. Mr. MOHAMED (Nigeria) suggested that some parts of chapter VII could be moved to chapter I, and the rest left in chapter VII, in order to maintain the balance of the text as a whole.

45. The CHAIRMAN said that there would then be a debate on which parts of chapter VII should be moved.

46. Mr. RENGER (Germany) said that in 1999 the Commission had already held an extensive debate on chapter VII. It should not reopen that debate.

47. Mr. DEWAST (European Lawyers Union) said that he supported the proposal that competition law should be included in chapter VII, because it was a very important subject for investors.

48. Mr. ESTRELLA FARIA (International Trade Law Branch) recalled that chapter VII had originally been part of chapter I, but had been repeatedly expanded through the addition of further areas of law and had eventually become a separate section and

moved to the end of the Guide. There had once been a separate chapter on competition law, but the Commission had decided that part of the chapter would be retained and incorporated into chapter I, and the rest would be deleted.

49. The CHAIRMAN stressed that the Commission should not reopen issues which had already been settled.

50. Mr. WALLACE (United States of America) said that if a streamlined version of chapter VII was incorporated in chapter I, that chapter would not be disproportionately long.

51. Mr. LALLIOT (France) said that his delegation was reluctant to take up either the substance of chapter VII, or competition law. His delegation had no firm view about whether chapter VII should be moved into chapter I, but noted that, since the chapters were of variable length, there would not be any significant imbalance in the structure of the *Guide*.

52. Mr. SARIE ELDIN (Egypt) proposed that chapter VII should become chapter II, so as to have a logical sequence from "General legislative and institutional framework" to "Other relevant areas of law". It would be unwise to embark on a discussion of chapter VII, or of the question of competition law.

53. Mr. WIWEN-NILSSON (Observer for Sweden) pointed out that there were already references to competition law in other parts of the *Guide*.

54. The CHAIRMAN said that there did not seem to be strong support for including competition law in chapter VII.

The meeting was suspended at 11.35 a.m. and resumed at 12.05 p.m.

55. The CHAIRMAN invited the Commission to comment on the proposal by the representative of Egypt that chapter VII should be relocated to follow chapter I.

56. Mr. WALLACE (United States of America), supported by Mr. REICHEL (Observer for the World Bank), supported the proposal.

57. Mr. MOHAMED (Nigeria) offered qualified support.

58. Mr. DARCY (United Kingdom) concurred: his delegation would not wish to countenance a prolonged debate on editorial and cosmetic issues. The adoption of the *Guide* was what really counted.

59. Mr. RENGER (Germany) said he preferred the order of chapters to remain unchanged. Chapter VII, dealing as it did with marginal points, had been placed at the end precisely so that it should not distract the reader from the main thrust of the *Guide*.

60. Mr. KASHIWAGI (Japan), Ms. GAVRILESCU (Romania) and Ms. MANGKLATANAKUL (Thailand) endorsed that view.

61. Ms. LI LING (China) said that, if chapter VII were relocated, it would be necessary to decide on a new title, which could involve lengthy discussions. The order of chapters should be left unchanged.

62. Mr. MARADIAGA (Honduras) said that the current placement was satisfactory, whereas relocating chapter VII might prove more complicated than expected, without leading to any substantial improvement.

63. Ms. SANDERSON (Observer for Canada) said that cosmetic changes could inadvertently turn into substantive changes. Chapter VII should therefore remain in its present position.

64. Mr. WIWEN-NILSSON (Observer for Sweden) said that, having listened to all the arguments, he too supported the view expressed by the representative of Germany.

65. The CHAIRMAN took it that the Commission was in favour of leaving the order of chapters unchanged.

66. *It was so decided.*

67. The CHAIRMAN invited the Commission to consider the desirability of including a consolidation of the legislative recommendations in the final presentation of the *Guide*.

68. Mr. HERRMANN (Secretary of the Commission) said that the secretariat was open to a request by the Commission that the legislative recommendations should appear in a consolidated form. He recommended, however, that rather than being issued separately, as in document A/CN.9/471/Add.9, they should appear in the same volume as the notes, which should be read in conjunction with them. A similar approach had been followed in earlier instances of legal documents. A subsidiary question was whether the recommendations should be repeated later in the volume together with the relevant notes. He would not advise that plan of action; the reader would find it easy to consult the recommendations, since they would be in the same volume.

69. Mr. MORÁN BOVIO (Spain) endorsed the Secretary's suggestion. There was no need to repeat the recommendations before the notes if they appeared in consolidated form at the start of the volume.

70. Ms. NIKANJAM (Islamic Republic of Iran) and Ms. GAVRILESCU (Romania) expressed support for the Secretary's suggestion.

71. Mr. WIWEN-NILSSON (Observer for Sweden) said that, if the suggestion was adopted, the first line of the foreword, contained in document A/CN.9/471/Add.9, would need to be changed.

72. The CHAIRMAN took it that, subject to the editorial change proposed by the observer for Sweden, the Commission wished to adopt the Secretary's suggestion.

73. *It was so decided.*

74. Mr. HAMILTON (Economic Commission for Europe) expressed his conviction that the *Guide* would prove a most valuable product. In Europe, in the 1990s, it had been assumed that a legal and regulatory framework was not as important as the existence of strong contracts between the public and private sectors. Experience had shown the exact opposite to be the case. The *Guide* would thus send a clear signal to Governments that legal and regulatory issues were vitally important for promoting public and private partnerships. The Economic Commission for Europe had promoted such partnerships over the past five years, with a particular emphasis on the transition economies of central and eastern Europe and the Commonwealth of Independent States. Considerable experience of the challenges in implementing such partnerships had thus been accumulated.

75. The need for a regulatory framework, a concession law, proper regulation for specific sectors, an efficient dispute resolution system and, in some instances, a constitutional framework

had been clearly understood. Some Governments had little or no experience of working with the private sector, and project development costs could be considerable. His Commission had therefore adopted a pragmatic approach, preparing tools to help Governments, including advisory guidelines that complemented the *Guide*.

76. Many Governments, however, were moving to the next stage, that of project implementation. They were therefore given help in developing projects that could lead to an improvement of their legal framework. They were also being helped to develop an appropriate structure for promoting public and private partnerships. In the Czech Republic, for example, model projects in the transport and other fields were to be established.

77. His Commission also aimed to increase the confidence of Governments in negotiating with foreign investors. According to the World Bank, in some countries in Asia contracts were often biased towards the investor's side, with the result that projects were either stopped or renegotiated, with a corresponding waste of time and resources. A negotiating platform had therefore been prepared in order to help Governments determine what their public interests were and how to protect them.

78. The "build-operate-transfer" (BOT) group, which carried out promotion work for his Commission, consisted of a network of over 100 experts from the public and private sectors, with practical business experience. A major strength of the group was its neutrality: it was not the preserve of any one sector. It sought to maintain a balance between East and West and between public and private. The group had received considerable help from the Commission's own experts.

79. Lastly, he suggested that the best way of disseminating the *Guide* would be to organize joint seminars with his Commission to help explain the *Guide* in a practical way. Experts from his Commission would also be ready to assist in developing a concession law for the European region, using the *Guide* as a basis, or else in developing standard documents on public and private partnership. Any such cooperation would save costs and would be to the mutual advantage of the two Commissions.

80. The CHAIRMAN called on all States to disseminate the legislative *Guide* and accompanying notes and thanked the Economic Commission for Europe (ECE) for offering to assist in that task.

81. He then invited the Commission to consider whether it wished to undertake any further work in the area of privately financed infrastructure projects.

82. Mr. MORÁN BOVIO (Spain) asked the secretariat to comment on the matter.

83. Mr. HERRMANN (Secretary of the Commission) said that when the Commission had begun its work on the *Guide*, the widely held view had been that it was not feasible to seek consensus on a model law or other statutory provisions. At present, however, he thought that it would be relatively easy to develop statutory provisions on the issue of procurement.

84. To be sure, the Commission's traditional task was to harmonize legal instruments and prepare uniform laws for international use. States with highly developed legal systems might have little interest, however, in amending their legislation to conform to a model law; it might be more feasible to provide model statutory provisions for adoption by States in need of them.

85. Before work on the *Guide* had begun, the legislation of some 80 countries had been examined and had revealed a wide variety of approaches to the topic; some national legal systems provided only an abstract framework while others included extremely detailed provisions. He therefore suggested that participants in the current session should be asked to comment on their specific needs rather than on the general desirability of such a project so that the Commission could assess not only the costs involved, but also how the differences in national legal systems could be accommodated in a model law.

86. One expert had suggested that as in the case of the Model Law on Procurement of Goods, Construction and Services, the Commission might develop a series of "road maps" that would include options appropriate to various legal systems.

87. Ms. NIKANJAM (Islamic Republic of Iran) said that States which had economies in transition and were endeavouring to attract foreign capital and modernize their infrastructure attached great importance to ensuring the establishment of fair, transparent domestic legislation and standards and to the harmonization of national legal systems in the field of trade. Since the Commission had completed its work on the *Guide*, she hoped that it would consider establishing a working group with a view to developing a model law or other statutory provisions that could be incorporated into domestic law as a basis for the implementation of project agreements.

88. Mr. LALLIOT (France) said he had hoped that the Secretary would reply in more practical terms; his delegation had sought information on alternatives to a model law; the procedure to be followed if one was to be developed, including the establishment of a working group or expert group; the costs involved; and a reasonable timetable for completion of the project in light of the Commission's existing agenda.

89. Mr. DARCY (United Kingdom) said that his delegation was somewhat sceptical about the proposed project's feasibility. The Commission had devoted four years to the *Guide* and might require as much or more time to develop a model law; States might not be prepared to wait so long, and it would be unwise to waste scarce resources if there was limited support for such an instrument. He therefore suggested that the secretariat should write to the Governments of all States members of the Commission in order to assess their interest in the proposal.

90. Mr. WALLACE (United States of America) said that his delegation had always been interested in the possibility of developing a model law. While it was true that a model law would not be of equal value to all Governments, it had been suggested that it might be used, inter alia, to harmonize legislation at the domestic level in a Federal system like that of his own country.

91. He agreed that the secretariat should be asked to contact Governments to assess their interest in such a project; however, he thought that the lessons learned during the Commission's work on the *Guide* would allow it to complete work on the model law within two years by establishing working groups. The Commission had addressed issues such as the form and content of draft model laws in the past with more success than it had been given credit for; his delegation had a number of suggestions to make in that regard. Above all, the Commission should remember that many countries desperately required investment in all sectors, especially that of infrastructure.

92. The CHAIRMAN suggested that the Commission should begin by asking participants whether their Governments were interested in the development of a model law.

The meeting rose at 1 p.m.

Summary record of the 703rd Meeting

Thursday, 29 June 2000, at 3 p.m.

[A/CN.9/SR.703]

Chairman: Mr. Jeffrey CHAN (Singapore)

The meeting was called to order at 3.10 p.m.

DRAFT LEGISLATIVE GUIDE ON PRIVATELY FINANCED INFRASTRUCTURE PROJECTS *(continued)*

1. Mr. HERRMANN (Secretary of the Commission), said that the alternative to a model law could be a compilation of model legislative provisions on certain aspects of the legislative *Guide*. The question of form, however, could be decided only after a general feasibility study had been done.

2. As to the financial implications, the length of time needed for drafting would be a factor. Also, if the proposed feasibility survey indicated that only five or six subject areas in addition to procurement required further work, the ultimate cost would be much lower than if all the subject areas in the legislative *Guide* needed coverage. Moreover, if a working group was established, the cost would be in the range of at least $150,000 for two weeks; whereas the cost of assembling a group of experts to assist the secretariat would be more limited. Owing to the existing schedules of the working groups, no time would be available for a working group session on any new topic until the next session of the Commission.

3. Mr. SARIE ELDIN (Egypt) said that the legislative *Guide* was a fine achievement but had not gone far enough. A model law of the kind previously adopted by UNCITRAL would represent a major development in international business law. The proposed model law should be an enabling law, to be used irrespective of sector or of the details of any particular legal system.

4. As the Commission had already spent four years on the *Guide*, it would probably require no more than two years to prepare the model law. If work could not begin before the next UNCITRAL session, perhaps a group of experts could be asked to make a first draft in the interim. At the appropriate time, his delegation was prepared to submit a list of the major issues to be covered.

5. Mr. ATWOOD (Australia) said that he supported the comments made at the previous meeting by the United Kingdom representative. His Government was neutral but was prepared to be guided by the views of those who felt a model law was needed. The process was, however, likely to be time-consuming and expensive. The provisions of the legislative *Guide*—a very useful tool in itself—would require thorough review. His delegation proposed that before committing time and resources to a further project on the topic, the Commission should assess the impact of the legislative *Guide* itself, which might prove to be by and large sufficient. The secretariat should seek the opinions of the users of the *Guide*, especially those States which would require further guidance and would benefit most from further UNCITRAL work in the field. It might be that any future work should focus on the legislative capacities of particular States rather than the development of a model law for all. At any rate, only after such assessments could the Commission make a fully informed decision.

6. Mr. LAMBERTZ (Observer for Sweden) said that he favoured considering the possibility of a model law or other instrument. It was too early to know if a working group would be appropriate, particularly as other projects had priority in the working groups. In any case, in order not to lose the momentum generated by the adoption of the legislative *Guide*, the Commission should decide now to authorize a feasibility study. With the assistance of experts, but without wasting time canvassing States, the secretariat should determine which areas were suitable for further work and which of those areas should take priority. It could even begin to draft some provisions if that was deemed appropriate.

7. Mr. RENGER (Germany) said that there was room for more work on the subject. He himself was not as optimistic as the Egyptian representative about the two-year time-frame for a model law. Moreover, a decision to draft a model law might be counter-productive, for countries would hold back from using the legislative *Guide* if they knew that further work was being done.

8. Generally, a model law was written as a uniform law, but a model law on privately financed infrastructure projects would be implemented according to the domestic context. It would therefore make sense to see how the legislative *Guide* worked in practice before embarking on a model law. UNCITRAL could draw up a joint project with the United Nations Conference on Trade and Development, the World Bank and the Economic Commission for Europe to identify countries that needed legislation in the field and to work with them in drafting laws on the basis of the legislative *Guide*. Once that had been done, the usefulness of a model law could be reconsidered.

9. Mr. MORÁN BOVIO (Spain) observed that UNCITRAL must proceed to unify law in an ordered and gradual way. Some time should be allowed to pass in order to assess the impact of the legislative *Guide* and hear what States had to say regarding their efforts to modify domestic law. There were precedents in the Commission for moving from guide to model law: the UNCITRAL Legal Guide on Electronic Funds Transfers had led to the UNCITRAL Model Law on Electronic Commerce after 12 to 15 years of work and had put UNCITRAL at the forefront of that field. There was surely a need for a model law in the field of privately financed infrastructure projects but it had to be determined which of the 70 recommendations in the *Guide* should be included in such a law. Far more than two years would be needed. The Commission should wait until the next session, and perhaps convening a group of experts would then be the logical first step.

10. Mr. MOHAMED (Nigeria) said that countries should be urged to use the legislative *Guide* while the Commission began to think about fashioning a model law. A group of experts could be invited to set out the possible parameters of a model law and submit a proposal to the Commission at its next session.

11. Mr. HERRMANN (Secretary of the Commission), after pointing out that the Commission itself was composed of experts, said that generally when the Commission set up expert groups, the members had to come at their own expense and were not expected to make policy decisions. There was no money for lan-

guage interpretation. He cautioned against trying to set up a body that was like a working group in all but name.

12. It would be odd for the Commission, having just adopted the legislative *Guide*, to address a question that would require a study of the considerable disparities in legislative approach among States, since it was those disparities which had led the Commission to decide on recommendations as the most suitable form in the first place. It was true that the Commission had adopted very successful model laws in the past. In the case of the UNCITRAL Model Law on Electronic Commerce with Guide to Enactment, however, the situation had been entirely different: the Commission had established common terminology and a descriptive guide before any country had enacted legal provisions dealing with the new technology.

13. Ms. SANDERSON (Observer for Canada) endorsed the suggestion that the secretariat should conduct a feasibility study with the assistance of experts.

14. Mr. WALLACE (United States of America) said that eventually the Commission would need to establish a working group. He would be willing to prepare a list of 10 issues which could be the subject of a preliminary draft.

15. Mr. LALLIOT (France) said that his delegation was less optimistic than other delegations that the Commission would be able to complete a draft model law in one year or less. The European Union had been discussing such an instrument since the early 1990s and had been unable to conclude its work. Since the Commission's budget did not allow for the convening of a working group before the next session, he proposed that the secretariat should convene an expert group whose composition would reflect all legal traditions. The expert group should determine whether a model law was feasible; if so, it should decide on the topics to be covered and begin work on a preliminary draft. It would then be for the Commission, and the Commission alone, to decide at a future session whether a working group was necessary and, if so, to establish its mandate.

16. The CHAIRMAN invited the secretariat to advise the Commission on the feasibility of convening an expert group with the characteristics stipulated in the French proposal.

17. Mr. HERRMANN (Secretary of the Commission) said that the phrase "all legal traditions" was sufficiently vague to enable the secretariat to meet that requirement.

18. Mr. ADENSAMER (Austria) said that he associated himself with those delegations which believed that a wait-and-see approach was indicated.

19. Mr. MARKUS (Observer for Switzerland) said that, since the Commission had already produced a legislative *Guide*, it was doubtful whether there would be an immediate need for a model law. He also failed to understand the need for an expert group since the members of the Commission were all experts.

20. Ms. GAVRILESCU (Romania) said that it was far too early to tell whether a model law would be desirable.

21. Mr. MARADIAGA (Honduras) said that the legislative *Guide* was an invaluable tool for governments that should not be overlooked. His Government had already adopted legislation based solely on the documents prepared for discussion in the Commission.

22. Mr. AL-NASSER (Saudi Arabia) said that he shared the views of those delegations which advocated a wait-and-see approach. The legislative *Guide* might prove to have a less beneficial impact in certain countries than was hoped.

23. Ms. LI LING (China) suggested that a working group should begin drafting a model law at the next session. If that effort was fruitful, then the Commission could decide whether to retain the legislative *Guide* or replace it with the model law.

24. Mr. KONKKOLA (Finland) said that it was too early to decide on future work. The matter should be deferred to the next session. He suggested that the secretariat should prepare a feasibility study listing the topics to be covered by a model law.

25. Mr. MORENO RUFFINELLI (Paraguay) said that much of the work to be done on a model law had already been completed. It would be prudent to wait for the legislative *Guide* to be adopted and implemented in several countries in order to determine its practicability. Consultations should be held with Governments and experts.

The meeting was suspended at 4.25 p.m. and resumed at 5 p.m.

26. The CHAIRMAN invited the Commission to resume its discussion of a model law to be based on the *Legislative Guide on Privately Financed Infrastructure Projects*. The sense of the debate seemed to be that work on the topic should continue with a view to a model law, but perhaps not before the next session of the Commission.

27. Mr. MAZINI (Observer for Morocco) said that the finished *Guide* was a remarkable achievement in a short time, but, speaking as the representative of a developing country, he felt that a model law was needed in order to harmonize national laws on the subject and thereby facilitate international cooperation. The *Guide* had already identified the basic legal principles for such a law. His impression was that there was a strong consensus on the need to elaborate a model law, but also a recognition that it would be expensive. His delegation seconded the French proposal to assemble a group of experts in the course of the year to sketch out the broad outlines of such a law based on the principles set forth in the *Guide*.

28. Mr. MOHAMED (Nigeria) said that there seemed to be consensus on the need for a model law. The question at hand was how to preserve the momentum on the topic. Of the proposals put forward, the French proposal for an expert group, or perhaps an intergovernmental group, to meet during the course of the year seemed the most appropriate. It was probable that the expert group could prepare a draft for consideration by the Commission.

29. Mr. PINZÓN SÁNCHEZ (Colombia) said that his delegation was convinced of the importance of elaborating a model law, and, of course, the thinking already done on the *Guide* could move the project forward considerably, if momentum was maintained, since the law would be a logical extension of the *Guide*. However, in deciding how to go forward, the Commission should be mindful of the potential problem raised by Germany. It would not be desirable for work on the model law to be construed as a lack of confidence in the *Guide*. In sum, his delegation was prepared to be flexible on the timing of the work, as long as there was basic agreement on the need for a model law.

30. Mr. DEWAST (Observer for the European Lawyers Union) said that the experience of France and the United Kingdom with the construction of the Eurotunnel had demonstrated the importance of a model law, even for developed countries. In the absence of such a mechanism of harmonization, the two countries had had to resort to special measures that had not proved entirely satisfactory. Hindsight had also made it clear that the sticking

points were relatively few, concerning chiefly real estate on the United Kingdom side and financing guarantees and rate-setting on the French side. Adoption of a model law covering even a few central issues would have considerably facilitated the job of promoters and lenders involved in the Eurotunnel project.

31. The task the Commission was proposing to set itself might not be as insurmountable as it at first appeared and would indisputably be of value to developed and developing countries alike.

32. Mr. MORÁN BOVIO (Spain) said that his delegation believed that the next step was to disseminate the *Guide* to Governments and interested organizations and wait for feedback. If Governments requested help with their laws on privately financed infrastructure, that would be time enough to take action. There was always a danger that projects were self-perpetuating, without reference to reality. Efforts should be put into disseminating the *Guide* thoroughly.

33. The proposal of convening an expert group raised certain difficulties. It would not be easy to assemble jurists from all legal systems. Nor could the expert group elaborate a draft based on the recommendations alone. The Commission had no time during the present session to elaborate a mandate and terms of reference for such a group or to decide which of the 70 recommendations should be the focus of attention.

34. Mr. SARIE ELDIN (Egypt) said his delegation did not believe that the Commission should wait for reactions to the *Guide*. In any case, during the current discussion at least 12 countries had expressed the opinions of their Governments that a model law was called for. Naturally, financing and time constraints must be considered in deciding when and how to proceed, but the Commission could certainly take a decision in principle to go forward with a model law.

35. Mr. HERRMANN (Secretary of the Commission) said that the notion that an expert group might be able to draft provisions of a model law was in conflict with the Commission's settled practice that its texts were drafted only by the Commission or by a working group that was a subsidiary body of the Commission. On a practical level, the Commission had a very small budget to spend on expert groups.

36. During the consultation break, an idea had been raised which he would like the Commission to consider. Rather than rush into the drafting of a model law, and possibly induce Governments to ignore the *Guide* while waiting for the law, the Commission could maintain momentum on the topic by holding a colloquium in collaboration with a partner, possibly a regional development bank. It had done something similar with its Colloquium on Cross-Border Insolvency prior to the elaboration of the Model Law on Cross-Border Insolvency.

37. The colloquium could probably be held during the first quarter of 2001, and experts on law reform assistance could be invited. It could serve the dual purpose of disseminating the *Guide* and exploring how much further one might go and in which subject areas. It would submit a report to the Commission at its next session, when the availability of working group time would be more evident.

38. The CHAIRMAN invited comments on the Secretary's suggestion of a colloquium and asked the members to bear in mind that it was not the Commission's practice to have expert groups draft its texts.

39. Mr. WALLACE (United States of America) said that a colloquium would be useful, because the Commission had not enjoyed the participation of many specialists in the field. However, if the Commission decided to hold a colloquium, he hoped it would not be too academic, and that the results of the Commission's work on the *Guide* would be available to the participants. While a model law would be of greatest benefit to the developing countries, it would also prove useful for developed countries, as experience had shown with the Eurotunnel. It was important to maintain momentum and also to avoid excessive complexity: 70 recommendations were too many, making it difficult to pin down the core provisions of the *Guide*.

40. The CHAIRMAN said that, if the secretariat was to prepare the agenda for a colloquium, it would need clear guidelines from the Commission.

41. Ms. NIKANJAM (Islamic Republic of Iran) questioned whether the Commission should await reactions to the *Guide* before deciding whether to proceed with a model law. That might mean waiting a long time, because the State authorities concerned had many other things to deal with. It would be better for the Commission to pursue the work it had begun.

42. Mr. RENGER (Germany) said that the understanding of a model law now being expressed in the Commission was as a means of persuading legislators to enact law rather than as a tool for the harmonization of commercial law. He supported the proposal to hold a colloquium, within parameters set by the Commission and, if possible, with the help of other institutions which would be playing a part in disseminating the *Guide*.

43. Mr. ATWOOD (Australia) said that the preparation of a model law was not the only way to maintain the momentum of the Commission's work. He thought the holding of a colloquium would be an excellent idea as it would enable the Commission to gain an understanding of the practical difficulties of particular States and the kind of assistance they needed and to make an informed decision on whether the preparation of a model law was an appropriate response. It would also minimize the risk that the *Guide* might not be fully exploited if the Commission immediately began work on a model law.

44. Mr. REICHEL (World Bank) said he would seek to ensure participation by the World Bank in any colloquium organized by the Commission.

45. Ms. SANDERSON (Observer for Canada) supported the proposal for a colloquium. As the United States representative had pointed out, not all the experts in the field had been present at the session, so it was important not to opt for any particular direction in the Commission's work on it. It was also important to keep up the momentum, and a colloquium would be a useful means of doing so. A report from the colloquium could then be taken up by the Commission at its next session.

46. Mr. AL-NASSER (Observer for Saudi Arabia) said a colloquium could be a useful contribution to the preparation of a model law. A draft model law could be produced quite soon, perhaps within two years.

47. Mr. LALLIOT (France) said that a colloquium had just been held at the University of Paris to review the Eurotunnel project, which was an example of privately financed infrastructure. As for a colloquium on the *Guide*, it would have to be decided how it would be financed and organized, who would attend, and how it would be followed up. It must not be used as a smokescreen to avoid solving difficult issues. If those conditions were met, the idea was acceptable, although not the best solution.

48. Mr. SARIE ELDIN (Egypt) was afraid that holding a colloquium might merely delay progress on the topic for a further year, so that the momentum of the Commission's work would be

lost. The rationale of its work, as the representative of Germany had said, was to promote the unification of commercial law, in both developed and developing countries. The preparation of a model law would not in any sense represent a deviation from that goal. However, he did not object to the proposal for a colloquium, provided that the Commission was clear about what it was intended to achieve.

49. The CHAIRMAN said that the secretariat's intention was to have a wide-ranging colloquium, which should seek responses to the *Guide* and ideas for its implementation, not merely provide a forum for discussion. The outcome of the colloquium would be reported to the next session of the Commission, which would then have to decide what action to take.

50. Mr. SARIE ELDIN (Egypt) emphasized his concern that work might be delayed for another year, especially if the colloquium did not produce any specific conclusions on the viability of a model law.

51. Mr. WALLACE (United States of America) said that although the Commission had done some good work on the legislative *Guide*, it should do more in order to meet the needs of the user countries and of other jurists. The proposed colloquium would serve that purpose if it focused on lawmaking and law reform.

52. Mr. MORÁN BOVIO (Spain) was convinced that a colloquium would be a very positive event. It was for the members of the Commission itself, rather than the secretariat, to ensure its success. The colloquium should benefit from the views of experts and interest groups in the field.

53. The CHAIRMAN, summarizing the discussion, said that there was wide support in the Commission for holding a colloquium, provided that it made a real contribution to progress on the topic. It should address the need for further work on the *Guide*, identify the core provisions, obtain responses to the *Guide* and monitor its implementation. It should identify issues which could be dealt with in other ways, including by way of a model law. A report from the colloquium would be submitted to the Commission's next session. The secretariat would endeavour to find a partner organization, preferably the World Bank, to assist with the organization of the colloquium, which should be open to anyone wishing to attend and should represent a wide range of views as well as the full spectrum of legal traditions. The colloquium should be held in the first quarter of 2001. If it was impossible for any reason to hold a colloquium, an expert group would be convened by the secretariat, within resources available to it, which would proceed along the same lines and report to the Commission at its next session.

The meeting rose at 6.05 p.m.

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Annex

UNCITRAL legal texts

Short title	*Full title*
Hamburg Rules (1978)	United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg)[a]
Limitation Convention (1974/1980)	Convention on the Limitation Period in the International Sale of Goods, 1974 (New York)[b] and Protocol amending the Convention on the Limitation Period in the International Sale of Goods, 1980 (Vienna)[c]
UNCITRAL Arbitral Proceedings Notes (1996)	UNCITRAL Notes on Organizing Arbitral Proceedings (1996)[d]
UNCITRAL Arbitration Rules (1976)	UNCITRAL Arbitration Rules (1976)[e]
UNCITRAL Conciliation Rules (1980)	UNCITRAL Conciliation Rules (1980)[f]
UNCITRAL Credit Transfer Law (1992)	UNCITRAL Model Law on International Credit Transfers (1992)[g]
UNCITRAL Electronic Commerce Law (1996)	Model Law on Electronic Commerce of the United Nations Commission on International Trade Law (1996)[h]
UNCITRAL International Countertrade Guide (1992)	UNCITRAL Legal Guide on International Countertrade Transactions (1992)[i]
UNCITRAL Electronic Funds Guide (1986)	UNCITRAL Legal Guide on Electronic Funds Transfers (1986)[j]
UNCITRAL Construction Contracts Guide (1987)	UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works (1987)[k]
UNCITRAL Infrastructure Projects Guide (2001)	UNCITRAL Legislative Guide on Privately Financed Infrastructure Projects (2001)[l]
UNCITRAL Model Arbitration Law (1985)	UNCITRAL Model Law on International Commercial Arbitration (1985)[m]
UNCITRAL Model Insolvency Law (1997)	UNCITRAL Model Law on Cross-Border Insolvency (1997)[n]
UNCITRAL Model Procurement Law (1994)	UNCITRAL Model Law on Procurement of Goods, Construction and Services (1994)[o]
UNCITRAL Bills and Notes Convention (1988)	United Nations Convention on International Bills of Exchange and International Promissory Notes (1988)[p]
United Nations Guarantee and Stand-by Convention (1995)	United Nations Convention on Independent Guarantees and Stand-by Letters of Credit (1995)[q]
United Nations Sales Convention (1980)	United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)[r]
United Nations Terminal Operators Convention (1991)	United Nations Convention on the Liability of Operators of Transport Terminals in International Trade (1991)[s]

Notes

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[d] *Official Records of the General Assembly, Fifty-first Session, Supplement No. 17* (A/51/17), part II.

[e] Ibid., *Thirty-first Session, Supplement No. 17* (A/31/17), para. 57.

[f] Ibid., *Thirty-fifth Session, Supplement No. 17* (A/35/17), para. 106.

[g] Ibid., *Forty-seventh Session, Supplement No. 17* (A/47/17), annex I.

[h] Ibid., *Fifty-first Session, Supplement No. 17* (A/51/17), annex I; see also General Assembly resolution 51/162, annex, of 16 December 1996.

[i]United Nations publication, Sales No. E.93.V.7.

[j]Ibid., Sales No. E.87.V.9.

[k]Ibid., Sales No. E.87.V.10.

[l]Ibid., Sales No. E.01.V.4.

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[n]Ibid., *Fifty-second Session, Supplement No. 17* (A/52/17), annex I.

[o]Ibid., *Forty-ninth Session, Supplement No. 17* and corrigendum (A/49/17 and Corr.1), annex I.

[p]Ibid., *Forty-second Session, Supplement No. 17* (A/42/17), annex I; see also General Assembly resolution 43/165, annex, of 9 December 1988.

[q]General Assembly resolution 50/48, annex, of 11 December 1995.

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[s]Official Records of the United Nations Conference on the Liability of Operators of Transport Terminals in International Trade, Vienna, 2-19 April 1991 (United Nations publication, Sales No. E.93.XI.3), part I, document A/CONF.152/13, annex.

IV. CHECK-LIST OF UNCITRAL DOCUMENTS

Document symbol	*Title or description*	*Location in present volume*

A. List of documents before the Commission at its thirty-third session

1. General series

A/CN.9/464	Provisional agenda, annotations thereto and scheduling of meetings of the thirty-third session	Not reproduced
A/CN.9/465	Report of the Working Group on Electronic Commerce on the work of its thirty-fifth session	Part two, III, A
A/CN.9/466	Report of the Working Group on International Contract Practices on the work of its thirty-first session	Part two, II, A
A/CN.9/467	Report of the Working Group on Electronic Commerce on the work of its thirty-sixth session	Part two, III, C
A/CN.9/468	Report of the Working Group on Arbitration on the work of its thirty-second session	Part two, IV, A
A/CN9/469	Report of the Working Group on Insolvency Law on the work of its twenty-second session	Part two, V, A
A/CN.9/470	Receivables financing: analytical commentary of the draft Convention on Assignment [in Receivables Financing] [of Receivables in International Trade]	Part two, II, E
A/CN.9/471	Report of the Secretary-General on privately financed infrastructure projects: draft chapters of a legislative guide on privately financed infrastructure projects	Part two, I
A/CN.9/471/Add.1	Introduction and background information on privately financed infrastructure projects	Part two, I
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A/CN.9/471/Add.3	Chapter II. Project risks and government support	Part two, I
A/CN.9/471/Add.4	Chapter III. Selection of the concessionaire	Part two, I
A/CN.9/471/Add.5	Chapter IV. Construction and operation of Infrastructure	Part two, I
A/CN.9/471/Add.6	Chapter V. Duration, extension and termination of the project agreement	Part two, I
A/CN.9/471/Add.7	Chapter VI. Settlement of disputes	Part two, I
A/CN.9/471/Add.8	Chapter VII. Other relevant areas of law	Part two, I
A/CN.9/471/Add.9	Consolidated legislative recommendations	Part two, I
A/CN.9/472 and Add.1-4	Draft Convention on Assignment [in Receivables Financing][of Receivables in International Trade]: compilation of comments by Governments and international organizations	Part two, II, F
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A/CN.9/477	Report of the Secretary-General on International Standby Practices (ISP98)	Part two, VI, A
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	2. Restricted series	
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A/CN.9/XXXIII/CRP.3	Observations by the secretariat of the International Institute for the Unification of Private Law on the Report of the Secretary-General on security interests current activities and future work	Not reproduced
A/CN.9/XXXIII/CRP.4	Proposal of the United States regarding the scope of the Convention	Not reproduced
A/CN.9/XXXIII/CRP.5	Proposal submitted by the delegation of Japan	Not reproduced
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B. List of documents before the Working Group on International Contract Practices at its thirty-first session

	1. Working papers	
A/CN.9/WG.II/WP.103	Provisional agenda	Not reproduced
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A/CN.9/WG.II/WP.106	Working paper submitted to the Working Group on International Contract Practices at its thirty-first session: Commentary to the draft Convention on Assignment in Receivables Financing (Part II): note by the secretariat	Part two, I, D
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A/CN.9/WG.II/XXXI/CRP.3/ Add.2	Proposal from the delegation of the United States of America to address the concerns expressed by the Banking Federation of the European Union	Not reproduced
A/CN.9/WG.II/XXXI/CRP.3/ Add.3	Proposal by the United States of America regarding proposed section II*bis* of Annex	Not reproduced
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V. LIST OF UNCITRAL DOCUMENTS REPRODUCED IN THE PREVIOUS VOLUMES OF THE *YEARBOOK*

This list indicates the particular volume, year, part, chapter and page where documents relating to the work of the Commission were reproduced in previous volumes of the *Yearbook;* documents that are not listed here were not reproduced in the *Yearbook.* The documents are divided into the following categories:

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*For the twenty-third session (Vienna, 11-22 December 2000), this Working Group was named: Working Group on International Contract Practices (see A/55/17, para.186).

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