

**United Nations  
Commission on  
International  
Trade Law**

**YEARBOOK**

**Volume XXI: 1990**



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**NOTE**

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

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

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## INTRODUCTION

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

The present volume consists of three parts. Part one contains the Commission's report on the work of its twenty-third session, which was held in New York from 25 June to 6 July 1990, and the action thereon by the United Nations Conference on Trade and Development (UNCTAD) and by the General Assembly.

In part two most of the documents considered at the twenty-third session of the Commission are reproduced. These documents include reports of the Commission's Working Groups dealing with international payments, procurement, and guarantees and stand-by letters of credit, as well as reports and notes by the Secretary-General and the Secretariat. Also included in this part are selected working papers that were before the Working Groups.

Part three contains a bibliography of recent writings related to the Commission's work, a list of documents before the twenty-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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<sup>1</sup>To date the following volumes of the *Yearbook of the United Nations Commission on International Trade Law* (abbreviated herein as *Yearbook* [year]) have been published:

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

## THE TWENTY-THIRD SESSION (1990)

### A. Report of the United Nations Commission on International Trade Law on the work of its twenty-third session (New York, 25 June-6 July 1990) [Original: English]\*

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\*Official Records of the General Assembly, Forty-fifth Session, Supplement No. 17 (A/45/17) (20 August 1990) (hereinafter referred to as "Report").

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INTRODUCTION

1. The present report of the United Nations Commission on International Trade Law covers the Commission's twenty-third session, held at New York from 25 June to 6 July 1990.

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

I. ORGANIZATION OF THE SESSION

A. Opening of the session

3. The United Nations Commission on International Trade Law (UNCITRAL) commenced its twenty-third session on 25 June 1990. The session was opened by Mr. Carl-August Fleischhauer, Under-Secretary-General for Legal Affairs.

B. Membership and attendance

4. General Assembly resolution 2205 (XXI) established the Commission with a membership of 29 States, elected by the Assembly. By resolution 3108 (XXVIII), the General Assembly increased the membership of the Commission from 29 to 36 States. The present members of the Commission, elected on 10 December 1985 and 19 October 1988, are the following States, whose term of office expires on the last day prior to the beginning of the annual session of the Commission in the year indicated:<sup>1</sup>

Argentina (1992), Bulgaria (1995), Cameroon (1995), Canada (1995), Chile (1992), China (1995), Costa Rica (1995), Cuba (1992), Cyprus (1992), Czechoslovakia (1992), Denmark (1995), Egypt (1995), France (1995), Germany, Federal Republic of (1995), Hungary (1992), India (1992), Iran (Islamic Republic of) (1992), Iraq (1992), Italy (1992), Japan (1995), Kenya (1992), Lesotho (1992), Libyan Arab Jamahiriya (1992), Mexico (1995), Morocco (1995), Netherlands (1992), Nigeria (1995), Sierra Leone (1992), Singapore (1995), Spain (1992), Togo (1995), Union of Soviet Socialist Republics (1995), United Kingdom of Great Britain and Northern Ireland (1995), United States of America (1992), Uruguay (1992) and Yugoslavia (1992).

5. With the exception of Costa Rica, Sierra Leone and Togo, all members of the Commission were represented at the session.

6. The session was attended by observers from the following States: Australia, Austria, Burkina Faso, Colombia, Congo, Democratic People's Republic of Korea, Ecuador, Finland, German Democratic Republic, Guinea, Holy See, Indonesia, Lebanon, Liberia, Mali, Norway, Oman, Pakistan, Philippines, Poland, Republic of Korea, Romania, Rwanda, Saudi Arabia, Sweden, Switzerland, Thailand, Uganda, United Republic of Tanzania, Vanuatu, Venezuela, Viet Nam and Yemen.

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

(a) *United Nations organs*

- United Nations Centre on Transnational Corporations
- United Nations Conference on Trade and Development

(b) *Intergovernmental organizations*

- Asian-African Legal Consultative Committee

(c) *Other international organizations*

- Inter-American Bar Association
- Inter-American Juridical Committee
- International Chamber of Commerce

<sup>1</sup>Pursuant to General Assembly resolution 2205 (XXI), the members of the Commission are elected for a term of six years. Of the current membership, 19 were elected by the Assembly at its fortieth session on 10 December 1985 (decision 40/313) and 17 were elected by the Assembly at its forty-third session on 19 October 1988 (decision 43/307). Pursuant to resolution 31/99 of 15 December 1976, the term of those members elected by the Assembly at its fortieth session will expire on the last day prior to the opening of the twenty-fifth regular annual session of the Commission, in 1992, while the term of those members elected at its forty-third session will expire on the last day prior to the opening of the twenty-eighth regular annual session of the Commission, in 1995.

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

#### 8. The Commission elected the following officers:

<i>Chairman:</i>	Mr. Michael Joachim Bonell (Italy)
<i>Vice-Chairmen:</i>	Ms. Ana Isabel Piaggi de Vanossi (Argentina) Mr. Christo Tepavitcharov (Bulgaria) Ms. Zhang Yue Jiao (China)
<i>Rapporteur:</i>	Ms. Oge Joy Sasegbon (Nigeria)

### D. Agenda

#### 9. The agenda of the session, as adopted by the Commission at its 427th meeting, on 25 June 1990, was as follows:

1. Opening of the session.
2. Election of the officers.
3. Adoption of the agenda.
4. Countertrade.
5. International payments.
6. New international economic order.
7. International contract practices.
8. Legal problems of electronic data interchange.
9. Co-ordination of work.
10. Status of conventions.
11. Training and assistance.
12. General Assembly resolutions on the work of the Commission.
13. Other business.
14. Date and place of future meetings.
15. Adoption of the report of the Commission.

### E. Adoption of the report

#### 10. At its 438th meeting, on 6 July 1990, the Commission adopted the present report by consensus.

## II. INTERNATIONAL COUNTERTRADE

#### 11. The Commission, at its nineteenth session, held in 1986, in the context of its discussion of a note by the Secretariat entitled "Future work in the area of the new

international economic order" (A/CN.9/277), considered its future work on the topic of countertrade and requested the Secretariat to prepare a preliminary study on the subject.<sup>3</sup>

12. At its twenty-first session, held in 1988, the Commission had before it a report entitled "Preliminary study of legal issues in international countertrade" (A/CN.9/302). The Commission made a preliminary decision that it would be desirable to prepare a legal guide on drawing up countertrade contracts. In order for it to decide what further action might be taken, the Commission requested the Secretariat to prepare for the Commission at its twenty-second session a draft outline of such a legal guide.<sup>4</sup>

13. At its twenty-second session, held in 1989, the Commission considered the report entitled "Draft outline of the possible content and structure of a legal guide on drawing up international countertrade contracts" (A/CN.9/322). It was decided that such a legal guide should be prepared by the Commission, and the Secretariat was requested to prepare for the next session of the Commission draft chapters of the legal guide.<sup>5</sup>

14. At the current session, the Commission had before it a report entitled "Draft legal guide on drawing up contracts in international countertrade transactions: sample chapters" (A/CN.9/332 and Add.1-7). The report contained a proposed structure of the legal guide (A/CN.9/332, para. 6), an outline of the chapter entitled "Introduction to legal guide" (A/CN.9/332/Add.1), and the following draft chapters: "II. Scope and terminology of legal guide" (A/CN.9/332/Add.1); "III. Contracting approach" (A/CN.9/332/Add.2); "IV. General remarks on drafting" (A/CN.9/332/Add.3); "V. Type, quality and quantity of goods" (A/CN.9/332/Add.4); "VI. Pricing of goods" (A/CN.9/332/Add.5); "IX. Payment" (A/CN.9/332/Add.6); and "XII. Security for performance" (A/CN.9/332/Add.7). Draft chapter VII, "Fulfilment of countertrade commitment" (A/CN.9/332/Add.8), was also before the Commission in some language versions but, because of its late submission, it was not considered by the Commission.<sup>6</sup>

15. A summary of the discussion in the Commission on the draft chapters (A/CN.9/332/Add.1-7) is contained in annex I to the present report.

16. At the conclusion of the discussion the Commission noted that there had been general agreement with the overall approach taken by the Secretariat in the draft chapters, both as to the structure of the legal guide and as to the nature of the description and advice contained therein.

<sup>2</sup>The elections took place at the 427th, 432nd and 433rd meetings, on 25, 27 and 28 June. In accordance with a decision taken by the Commission at its first session, the Commission has three Vice-Chairmen, so that, together with the Chairman and the Rapporteur, each of the five groups of States listed in General Assembly resolution 2205 (XXI), sect. II, para. 1, will be represented on the bureau of the Commission (see the report of the United Nations Commission on International Trade Law on the work of its first session, *Official Records of the General Assembly, Twenty-third Session, Supplement No. 16 (A/7216)*, para. 14) *Yearbook of the United Nations Commission on International Trade Law, vol. I: 1968-1970* (United Nations publication, Sales No. E.71.V.1, part two, I, A, para. 14).

<sup>3</sup>*Official Records of the General Assembly, Forty-first Session, Supplement No. 17 (A/41/17)*, para. 243.

<sup>4</sup>*Ibid.*, *Forty-third Session, Supplement No. 17 (A/43/17)*, paras. 32-35.

<sup>5</sup>*Ibid.*, *Forty-fourth Session, Supplement No. 17 (A/44/17)*, paras. 245-249.

<sup>6</sup>Draft chapter VII, to be considered by the twenty-third session of the Working Group on International Payments (New York, 3-13 September 1991), will be reproduced in volume XXIII of the *Yearbook* (1991).



17. The Commission then considered the procedure that should be followed to complete the preparation of the legal guide. It was decided that the Secretariat should complete the preparation of the remaining draft chapters and submit them, together with draft chapter VII (A/CN.9/332/Add.8),<sup>b</sup> to a working group for consideration. While there was general agreement that it would be preferable if the draft chapters could be submitted to the Working Group on the New International Economic Order, it was recognized that that Working Group was currently fully occupied and that, as a result, the draft chapters might be submitted to the Working Group on International Payments, which would be available in 1991. In view of the time it would take the Secretariat to complete the preparation of the draft chapters, it was agreed that the meeting of the Working Group might be scheduled for September 1991.

18. The Commission decided that the Secretariat should redraft the chapters submitted to it at its current session and the chapters to be submitted to the Working Group in the light of the discussion at the current session and at the session of the Working Group and should submit the final text of the legal guide to the Commission at its twenty-fifth session, to be held in 1992.

### III. INTERNATIONAL PAYMENTS

19. The Commission decided, at its nineteenth session, in 1986, to begin the preparation of model rules on electronic funds transfers and entrusted that task to the Working Group on International Payments.<sup>6</sup>

20. The Working Group commenced its work at its sixteenth session by considering, on the basis of a note by the Secretariat, a number of legal issues that might be considered for inclusion in the model rules (see A/CN.9/297). The Working Group requested the Secretariat to prepare draft provisions based on the discussions during its sixteenth session.

21. At its seventeenth session, the Working Group considered the draft provisions prepared by the Secretariat, and at the close of that session the Working Group requested the Secretariat to prepare a revised draft of the Model Rules (see A/CN.9/317).

22. At its eighteenth session, the Working Group considered the provisions that had been redrafted by the Secretariat and made the following decisions: that the provisions should be prepared in the form of a model law; that the scope of application of the model law should be limited to those credit transfers that were international in nature; and that the model law should apply to all international credit transfers without regard to whether they were in electronic or paper-based form (A/CN.9/318). In view of the last-mentioned decision, the Working Group decided that the title of the draft provisions should be "draft Model Law on International Credit Transfers".

23. At its current session, the Commission had before it the reports of the Working Group on the work of its nineteenth and twentieth sessions (A/CN.9/328 and A/CN.9/329). The reports indicated that the Working Group had continued its consideration of the draft Model Law.

24. The Commission noted that at the close of the twentieth session of the Working Group the delegation of the United States of America had expressed its concern about the direction that the Model Law project had taken and had suggested the possibility of separating the Model Law into two parts, one applicable to high-speed electronic systems and the other applicable to slower systems.

25. The Commission noted that the United States of America had submitted a specific proposal to implement its suggestion and that that proposal would be before the Working Group at its next session, to be held in New York from 9 to 20 July 1990. The Commission expressed its confidence that the Working Group would be able to resolve the outstanding issues before it so that a text could be presented to the Commission at its twenty-fourth session, to be held in 1991.

### IV. PROCUREMENT

26. At its nineteenth session, in 1986, the Commission decided to undertake work in the area of procurement as a matter of priority and entrusted that work to the Working Group on the New International Economic Order.<sup>7</sup> The Working Group commenced its work on the topic at its tenth session, held at Vienna from 17 to 25 October 1988 (A/CN.9/315), by considering a study of procurement prepared by the Secretariat. At the close of its tenth session the Working Group requested the Secretariat to prepare a first draft of a model law on procurement and an accompanying commentary taking into account the discussions and decisions at the session (A/CN.9/315, para. 125).

27. At its current session, the Commission had before it the report of the Working Group on the work of its eleventh session, held in New York from 5 to 16 February 1990 (A/CN.9/331), at which the Working Group considered the draft of a model law on procurement prepared by the Secretariat.<sup>8</sup> At the close of its eleventh session the Working Group requested the Secretariat, for the twelfth session, to prepare draft provisions of the model law dealing with redress for actions and decisions taken by the procuring entity contrary to the provisions of the model law and to revise the text of the draft model law to take into account the discussions and decisions at the eleventh session (A/CN.9/331, para. 222).

28. During the discussion in the Commission the view was expressed that the work on the model law should take into account its possible relevance to procurement con-

<sup>7</sup>*Ibid.*, para. 243.

<sup>8</sup>A/CN.9/WG.V/WP.24, with a commentary in A/CN.9/WG.V/WP.25.

<sup>6</sup>*Ibid.*, Forty-first Session, Supplement No. 17 (A/41/17), para. 230.

ducted by private companies. It was stated that for certain large purchases such companies were increasingly resorting to the types of procedures laid down in the draft model law.

29. The Commission expressed appreciation for the work performed by the Working Group so far and requested it to proceed with its work expeditiously.

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

30. The Commission, at its twenty-second session, in 1989, decided that work on a uniform law on guarantees and stand-by letters of credit should be undertaken and entrusted that task to the Working Group on International Contract Practices.<sup>9</sup>

31. At its current session, the Commission had before it the report of the Working Group on the work of its thirteenth session (A/CN.9/330). The Commission noted that the Working Group had commenced its work by considering possible issues of a uniform law as discussed in a note by the Secretariat (A/CN.9/WG.II/WP.65). Those issues related to the substantive scope of the uniform law, party autonomy and its limits, and possible rules of interpretation. The Commission also noted that the Working Group had engaged in a preliminary exchange of views on issues relating to the form and time of establishment of the guarantee or stand-by letter of credit.

32. The Commission further noted that the Working Group had requested the Secretariat to submit to the next session of the Working Group, to be held at Vienna from 3 to 14 September 1990, a first draft set of articles, with possible variants, on the above issues as well as a note discussing other possible issues to be covered by the uniform law.

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

#### VI. LEGAL PROBLEMS OF ELECTRONIC DATA INTERCHANGE

34. The Commission, at its seventeenth session, in 1984, decided to place the subject of the legal implications of automatic data processing for the flow of international trade on its programme of work as a priority item.<sup>10</sup> It did so after considering a report of the Secretary-General entitled "Legal aspects of automatic data processing" (A/CN.9/254), which identified several legal issues, relating, namely, to the legal value of computer records, the requirement of a writing, authentication, general conditions and bills of lading.

35. At its eighteenth session, in 1985, the Commission had before it a report by the Secretariat entitled "Legal value of computer records" (A/CN.9/265). The report came to the conclusion that, on a global level, there were fewer problems in the use of data stored in computers as evidence in litigation than might have been expected. It noted that a more serious legal obstacle to the use of computers and computer-to-computer telecommunications in international trade arose out of requirements that documents had to be signed or be in paper form. At that session, the Commission recommended to Governments, *inter alia*, that they should eliminate unnecessary obstacles to the use of computers in trade, and recommended to international organizations elaborating legal texts related to trade that they take account of the need to eliminate unnecessary obstacles to the use of computers in trade.<sup>11</sup>

36. At its nineteenth and twentieth sessions, in 1986 and 1987, the Commission had before it two further reports on the legal aspects of automatic data processing (A/CN.9/279 and A/CN.9/292), which described and analysed the work of international organizations active in the field of automatic data processing.

37. At its twenty-first session, in 1988, the Commission considered a proposal to examine the need to provide for the legal principles that would apply to the formation of international commercial contracts by electronic means. It was noted that there currently existed no refined legal structure for the important and rapidly growing field of formation of contracts by electronic means and that future work in that area could help to fill a legal vacuum and to reduce uncertainties and difficulties encountered in practice. The Commission requested the Secretariat to prepare a preliminary study on the topic.<sup>12</sup>

38. At the current session, the Commission had before it the report that it had requested, entitled "Preliminary study of legal issues related to the formation of contracts by electronic means" (A/CN.9/333). The report noted that in prior reports the subject had been considered under the general heading of "automatic data processing" (ADP) but that, in recent years, the term generally used to describe the use of computers for business applications had been changed to "electronic data interchange" (EDI).

39. The report summarized work that had been undertaken in the European Communities and in the United States of America on the requirement of a writing as well as other issues that had been identified as arising in the formation of contracts by electronic means. The efforts to overcome some of those problems by the use of model communication agreements was also discussed. The report suggested that the Secretariat might be requested to submit a further report to the next session of the Commission indicating developments in other organizations dur-

<sup>11</sup>*Ibid.*, Fortieth Session, Supplement No. 17 (A/40/17), para. 360. The recommendation was endorsed by the General Assembly in its resolution 40/71, para. 5 (b), of 11 December 1985.

<sup>12</sup>*Official Records of the General Assembly, Forty-third Session, Supplement No. 17 (A/43/17), paras. 46 and 47, and ibid., Forty-fourth Session, Supplement No. 17 (A/44/17), para. 289.*

<sup>9</sup>*Official Records of the General Assembly, Forty-fourth Session, Supplement No. 17 (A/44/17), para. 244.*

<sup>10</sup>*Ibid.*, Thirty-ninth Session, Supplement No. 17 (A/39/17), para. 136.

ing the year relevant to the legal issues arising in EDI. That report might also analyse existing and proposed model communication agreements with a view to recommending whether a model agreement should be available for world-wide use and, if so, whether the Commission should undertake its preparation.

40. The Commission expressed its appreciation for the report submitted to it and requested the Secretariat to continue its examination of the legal issues related to the formation of contracts by electronic means and to prepare for the Commission at its twenty-fourth session the report that had been suggested. The Commission expressed the wish that the report would give it the basis on which to decide at that time what work might be undertaken by the Commission in the field. A number of delegations expressed the view that the Commission should give priority to the topic. However, a view was also expressed that work on that topic should not have priority over other subjects on the Commission's agenda.

## VII. CO-ORDINATION OF WORK

41. The Commission had before it a report of the Secretary-General on current activities of international organizations related to the harmonization and unification of international trade law (A/CN.9/336). That report updated the information contained in a report on the same subject submitted to the Commission at its twenty-second session (A/CN.9/324) and dealt with the activities under the following headings: international commercial contracts in general; commodities; industrialization; transnational corporations; transfer of technology; industrial and intellectual property law; international payments; international transport; international commercial arbitration; private international law; trade facilitation; and other topics of international trade law, congresses and publications.

42. The Commission noted that the report was a valuable compilation of information on the activities of international organizations related to the harmonization and unification of international trade law and that it assisted the Commission in developing its own programme of work and fostering co-ordination in the activities of the various international organizations.

## VIII. STATUS OF CONVENTIONS

43. The Commission considered the state of signatures, ratifications, accessions and approvals of conventions that were the outcome of its work, that is, the Convention on the Limitation Period in the International Sale of Goods ("the Limitation Convention"), the Protocol amending the Limitation Convention, the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg) ("the Hamburg Rules"), the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) ("the United Nations Sales Convention") and the United Nations Convention on International Bills of Exchange and International Promissory Notes. The Commission also considered the status of the

Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). In addition, the Commission took note of the jurisdictions that had enacted legislation based on the UNCITRAL Model Law on International Commercial Arbitration. The Commission had before it a note by the Secretariat on the status of those Conventions and of the Model Law as of 16 May 1990 (A/CN.9/337).

44. The Commission was pleased to note that, since the report submitted to the Commission at its twenty-second session, in 1989, the German Democratic Republic had ratified the Limitation Convention and its amending Protocol. The Commission noted with pleasure that, since the previous session, the Protocol amending the Limitation Convention had also been ratified by Czechoslovakia. As a result of those actions seven States were now parties to the Limitation Convention as amended by the Protocol, while four States were parties to the unamended Convention.

45. The Commission took pleasure in noting that an additional three States, namely, Burkina Faso, Kenya and Lesotho, had acceded to the Hamburg Rules, bringing the total number of parties to 17. The Secretary of the Commission reaffirmed the expectation of the Secretariat that the additional three ratifications or accessions necessary for the Convention to come into force would take place in the near future.

46. With respect to the United Nations Sales Convention, the Commission noted with satisfaction that the following seven additional States had become parties to the Convention: Byelorussian Soviet Socialist Republic, Chile, Czechoslovakia, Germany, Federal Republic of, Iraq, Switzerland and Ukrainian Soviet Socialist Republic. The total number of parties to the Convention was currently 26. The representatives of Bulgaria and of the Union of Soviet Socialist Republics informed the Commission that the necessary acts concerning accession to the Convention had been adopted and that the instruments of accession would be deposited shortly. Representatives and observers of a number of other States reported that official action was being taken that was expected to lead to the accession to the Convention in the near future.

47. The Commission noted with pleasure that Canada, the Union of Soviet Socialist Republics and the United States of America had signed the United Nations Convention on International Bills of Exchange and International Promissory Notes.

48. With respect to the UNCITRAL Model Law on International Commercial Arbitration, the representatives and observers of a number of States informed the Commission that legislation based on the Model Law was being prepared.

49. The Commission took note of a request by the Secretary that the Secretariat be provided with copies of legislation by which legal texts developed by UNCITRAL had been brought into force or had been implemented.

## IX. TRAINING AND ASSISTANCE

50. The Commission had before it a note by the Secretariat that set out the activities that had been carried out in respect of training and assistance during the prior year as well as possible future activities in that field (A/CN.9/335). The note indicated that since the Commission had stated at its twentieth session, in 1987, "that training and assistance was an important activity of the Commission and should be given a higher priority than it had in the past",<sup>13</sup> the Secretariat had endeavoured to devise a more extensive programme of training and assistance than had been previously carried out. In doing so the Secretariat had kept in mind the decision of the Commission at its fourteenth session, in 1981, that a major purpose of the training and assistance activities should be the promotion of the texts that had been prepared by the Commission.<sup>14</sup>

51. The Commission had been informed at its twenty-second session, in 1989, that the Secretariat was planning to organize a seminar, to be held at New Delhi in October 1989, jointly with the Asian-African Legal Consultative Committee (AALCC). The seminar, which was also sponsored by UNCTAD and the International Institute for the Unification of Private Law (UNIDROIT), was held from 12 to 16 October 1989.

52. The purpose of the seminar was to promote awareness in the Asian States members of AALCC of the conventions and other legal texts prepared by the sponsoring organizations. The majority of the participants were from the embassies of the respective States at New Delhi. In addition, the seminar was attended by members of the Indian Council of Arbitration.

53. A seminar hosted by the Government of Guinea and organized in conjunction with the Ministry of Foreign Affairs of that country was held at Conakry from 27 to 29 March 1990. Approximately 120 participants from interested ministries, the university and the private sector attended the seminar, which was intended to familiarize a broad cross-section of the local legal community with the UNCITRAL legal texts. It was noted that national seminars of that type were an effective way of informing a significant number of individuals in a given country of the work of the Commission.

54. At its twenty-second session, in 1989, the Commission had been informed of a seminar on the work of the Commission planned to be held in Moscow in 1990. Twenty-one participants from developing countries attended the seminar, which was financed from a trust fund established by the Union of Soviet Socialist Republics with the United Nations Development Programme (UNDP) for the training of individuals from developing countries. The seminar, which was hosted by the School of International Private and Civil Law and the School of International Business of the Moscow State Institute for Foreign Relations, took place from 17 to 21 April 1990.

55. The Commission noted that members of the UNCITRAL secretariat had participated as speakers in a number of other seminars, conferences, courses and professional meetings at which UNCITRAL legal texts were presented for examination and discussion.

56. The Secretariat reported that it was holding discussions for further seminars to be held in developing countries in different parts of the world. A seminar for the 17 francophone States of North and West Africa was planned for the fourth quarter of 1990. Tentative plans had been made with the Comisión Centroamericana de Transporte Marítimo (COCATRAM) to sponsor a series of seminars on the Hamburg Rules in each of the States members of COCATRAM in September 1990. The Secretariat was also holding discussions with the secretariat of the South Pacific Bureau for Economic Co-operation (SPEC) with a view to sponsoring a seminar in the Pacific region some time in 1991.

57. The Secretariat reported that, as announced to the Commission at its twenty-second session, it intended to organize the fourth UNCITRAL Symposium on International Trade Law on the occasion of the twenty-fourth session of the Commission, to be held in 1991.

58. The Commission expressed its appreciation to all those who had participated in the organization of the various seminars, and in particular to the Asian-African Legal Consultative Committee and the Moscow State Institute for Foreign Relations for their aid in organizing the seminars at New Delhi and Moscow. The Commission also expressed its appreciation to the Governments of Canada, Finland and Switzerland, whose generous contributions to promote the work of the Commission, made on a multi-year basis, had permitted the Secretariat to plan and carry out the expanded programme of seminars. Appreciation was expressed to the Government of the Union of Soviet Socialist Republics for its aid in securing the financing of the seminar in Moscow from the USSR-UNDP Trust Fund. Appreciation was also expressed to the Government of France for its contribution that would make possible the holding of the seminar for the francophone States of North and West Africa, as well as to the Government of Luxembourg for its contribution for that seminar.

59. The Commission noted that the continuation, and further expansion, of the programme of training and assistance depended on the continued availability of sufficient financial resources. It further noted that those resources were not available from the regular budget. Contributions made to the UNCITRAL Trust Fund on a multi-year basis were of particular value in that they permitted the Secretariat to plan and finance the programme without the need to solicit funds from potential donors for each individual activity.

60. The Commission also noted that the Secretariat had announced plans for a number of individual seminars to be held during the next year, including the fourth UNCITRAL Symposium on International Trade Law, mentioned in paragraph 57 above. The Commission encouraged all States to consider making contributions towards the financing of one or more of those individual

<sup>13</sup>*Ibid.*, Forty-second Session, Supplement No. 17 (A/42/17), para. 335.

<sup>14</sup>*Ibid.*, Thirty-sixth Session, Supplement No. 17 (A/36/17), para. 109.

seminars, if an unrestricted contribution to the UNCITRAL Trust Fund was not possible.

61. The Commission expressed its approval of the activities of the Secretariat that had led to the expanded programme of seminars and symposia. It requested the Secretariat to continue its efforts to secure the financial, staff and administrative support necessary to place the programme on a firm and continuing basis.

## X. RELEVANT GENERAL ASSEMBLY RESOLUTIONS AND OTHER BUSINESS

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

62. The Commission took note with appreciation of General Assembly resolution 44/33 of 4 December 1989 on the report of the United Nations Commission on International Trade Law on the work of its twenty-second session and of the decision of the General Assembly expressed in that resolution to convene an international conference of plenipotentiaries at Vienna from 2 to 19 April 1991 to consider the draft convention on the liability of operators of transport terminals in international trade.

### B. Convention on the Limitation Period in the International Sale of Goods

63. At its twenty-second session, in 1989, the Commission had noted that the Convention on the Limitation Period in the International Sale of Goods (New York, 1974) had been established in the five languages in which the diplomatic conference had been held and that, since Arabic had not been one of the languages of the conference, the Convention did not exist in that language. However, the Protocol amending the Convention on the Limitation Period in the International Sale of Goods (Vienna, 1980) had been adopted in Arabic. At that session the Commission had decided to request the preparation of an Arabic language version of the Convention as amended by the Protocol.<sup>15</sup> At the current session the Commission noted that in paragraph 9 of resolution 44/33 the General Assembly had approved "the initiative of the Commission to have prepared an official Arabic language version of the Convention . . .".

64. The Commission had before it at the current session a proposed text of the Convention as amended as translated into Arabic by the Secretariat (A/CN.9/334). The translation was reviewed and corrected by representatives of the interested delegations in co-operation with the Arabic Translation Service. The Commission requested the Secretary-General as depositary of the Convention to circulate the Arabic language version of the Convention as amended, and as reproduced in annex II to the present report, for comments prior to its publication as the official Arabic version of the Convention as amended.

<sup>15</sup>*Ibid.*, Forty-fourth Session, Supplement No. 17 (A/44/17), para. 264.

### C. Membership of the Commission and of working groups

65. It was noted that at its twenty-first session, in 1988, the Commission, on the basis of a note entitled "Working methods of the Commission" (A/CN.9/299), had considered the question of a possible increase in the membership of the Commission. At that session the Commission had taken no decision on the question and had agreed to reconsider the matter at its twenty-third session.<sup>16</sup> At the current session, the Commission decided to postpone the consideration of the question to a later session.

66. It was also noted that the note submitted to the Commission at its twenty-first session had in addition set out the history of the Commission's decisions as to the membership of its working groups (A/CN.9/299, paras. 13-31). At various times the size of the working groups had been increased so that currently all three working groups were composed of all States members of the Commission. The Commission noted that when it had decided at its twenty-first session to postpone consideration of the size of the Commission, it had also decided to postpone consideration of the membership of the working groups.

67. At the current session, it was suggested that in some cases it was important that all States members of the Commission should be members of a working group, while in other cases it might be sufficient if the working group was composed of a limited number of States. It was stated that, since active participation in a meeting of a working group often required the travel of an expert from the country concerned to New York or Vienna, the cost to the member States was increased when the working groups were composed of all member States of the Commission. It was suggested that the optimal size of a working group depended upon factors such as the type of legal text under consideration and the kinds of issues that were to be resolved in the working group.

68. In reply it was stated that the policy of inviting all States to attend sessions of the Commission and its working groups as observers was an indication of the importance placed on the participation of all interested States in every stage of the work of the Commission, including the preliminary stages in the development of the legal texts it prepared. It was stated that even when representatives of States, whether members of the Commission or observers, were passive in the conduct of a meeting, their attendance and the reports they submitted to their Governments were important elements in the world-wide awareness and acceptability of the Commission's work.

69. In view of the discussion, the Commission decided that it would not change the current policy that its three working groups should be composed of all States members of the Commission. It noted that when a working group was given a new mandate, it would be possible, if it seemed appropriate at the time, to reconsider the size of that working group for the period of the specific mandate.

<sup>16</sup>*Ibid.*, Forty-third Session, Supplement No. 17 (A/43/17), paras. 111-116.

#### D. United Nations Decade of International Law

70. The Commission noted that the General Assembly, in its resolution 44/23 of 17 November 1989, had declared the period 1990-1999 as the United Nations Decade of International Law. In that resolution, the General Assembly had requested the Secretary-General to seek the views of appropriate international bodies on the programme for the Decade and on appropriate action to be taken during the Decade. The Commission had before it a note by the Secretariat that brought the resolution to the attention of the Commission (A/CN.9/338).

71. The Commission observed that the programme for the Decade should take account of the fact that international trade law was an important and integral part of international law; in particular, the Commission's work was an important element in strengthening the rule of law in international economic relations.

72. The discussion in the Commission concentrated on how the Commission itself might take the occasion of the Decade to further strengthen and develop its programme of work. Several types of activities were identified in the discussion as being particularly appropriate for inclusion in the programme for the Decade. One activity was to strengthen the teaching, study, dissemination and wider appreciation of the law of international trade. Another activity was the promotion of acceptance of legal texts emanating from the work of the Commission and from the work of other intergovernmental and non-governmental organizations active in the area of international trade law. The observation was made that in respect of international law in general, and international trade law in particular, the wider adoption and effective implementation of existing texts was often of greater value than was the elaboration of new texts. The Commission noted that its activities in respect of the teaching, study, dissemination and wider appreciation of international trade law, with the associated promotion of the adoption and use of existing texts, had been more limited than was desirable because of the limited resources that had been available for them.

73. The Commission noted that the suggested activities relating to the teaching, study, dissemination, wider appreciation and promotion of international trade law would have their impact in all regions, but that they would be of greatest significance in developing countries. In the same spirit, a suggestion was made that an attempt should be made to find a way to finance the travel of experts from developing countries, and especially from States members of the Commission, to the sessions of the Commission and its working groups so that those States would be in a better position to contribute actively to the creation of international trade law.

74. In respect of the future activities of the Commission in the preparation of legal texts, it was suggested that the Commission could contribute to the Decade by undertaking work on a subject that was of underlying fundamental significance for the further development of the law of international trade, such as the formulation of general

principles of contract law or of general principles in particular areas of international trade law. It was also suggested that the Secretariat might review the proposals made in past years for the programme of work that had not been acted upon, as well as subjects on which work had begun but had been terminated prior to the adoption of a legal text, to determine whether some of those items might now be appropriate for the current programme of work. Under one suggestion the Secretariat would be requested to prepare a proposed programme of work for the Commission for the period of the Decade. Furthermore, it was suggested that the preparatory work by the Secretariat relating to the Decade should address the question of the harmonization between the universal and the regional codification of international trade law. It was proposed that one plenary session of the Commission should be dedicated to a review of developments in the field of international trade law from 1980 onward.

#### E. UNCITRAL Yearbook and bibliography

75. The Commission recalled that at its twenty-second session it had expressed its concern about the long delay in the publication of the *Yearbook of the United Nations Commission on International Trade Law* and that it had requested the Secretariat to take the necessary actions so that the *Yearbook* for a given year would be published by the end of the following year.<sup>17</sup> The Commission noted with satisfaction that considerable progress had been made towards eliminating the long delay in the publication of the *Yearbook*. It further noted that it was expected that the 1989 *Yearbook* would be published in all languages by the end of 1990, thereby meeting the desired publication schedule. The Commission expressed its appreciation for the efforts of the Secretariat in this regard, including the efforts of the publication services at Vienna. The Secretariat was requested to continue its efforts to ensure that the *Yearbook* for a given year would be published by the end of the following year.

76. The Commission noted with appreciation the bibliography of recent writings related to the work of the Commission (A/CN.9/339).

#### F. Date and place of the twenty-fourth session of the Commission

77. It was decided that the Commission would hold its twenty-fourth session from 10 to 28 June 1991 at Vienna.

#### G. Sessions of the working groups

78. The Commission recalled its decision that the Working Group on International Contract Practices would hold

<sup>17</sup>*Ibid.*, Forty-fourth Session, Supplement No. 17 (A/44/17), para. 291.

its fourteenth session from 3 to 14 September 1990 at Vienna, and agreed that the Working Group would hold its fifteenth session from 13 to 24 May 1991 in New York (subject to confirmation in late August 1990) and its sixteenth session from 4 to 15 November 1991 at Vienna.

79. The Commission recalled its decision that the Working Group on the New International Economic Order would hold its twelfth session from 8 to 19 October 1990 at Vienna and agreed that the Working Group would hold its thirteenth session from 15 to 26 July 1991 in New York

and its fourteenth session from 2 to 13 December 1991 at Vienna.

80. The Commission noted that the Working Group on International Payments would hold its twenty-first session from 9 to 20 July 1990 in New York and its twenty-second session from 26 November to 7 December 1990 at Vienna. The Commission decided that the twenty-third session would be held from 2 to 13 September 1991 in New York to consider the remaining draft chapters of the legal guide on drawing up contracts in international countertrade transactions.

## ANNEX I

### Discussion on the draft legal guide on drawing up contracts in international countertrade transactions

#### General discussion

1. The Commission engaged in a general discussion of the purpose, approach and structure of the draft legal guide on drawing up contracts in international countertrade transactions (A/CN.9/332 and Add.1-7).

2. The Commission reviewed the rationale behind its work on the legal guide. On the one hand, it was stated that, due to economic difficulties of many countries, parties engaged in countertrade arrangements and that those parties often did not find optimal solutions to contractual issues that arose in such arrangements. As a result, it was considered that a legal guide on drawing up contracts in international countertrade would be useful to participants in that type of trade. On the other hand, it was stated that countertrade was an inefficient manner to carry on international trade and was detrimental to both developed and developing States in that it distorted competition in international markets as well as the terms of trade of the participants themselves. In the light of that observation, views were expressed that the legal guide should be drafted in such a way that it would not indicate specific approval of that type of trade or encourage parties to engage in it.

3. It was noted that the Economic Commission for Europe (ECE) was preparing a guide on legal aspects of new forms of industrial co-operation in East-West trade and that a part of that guide was devoted to legal aspects of international counterpurchase contracts and international buy-back contracts. The Commission was of the view that the legal guide to be prepared by it would not duplicate the work of ECE since the membership of the Commission was universal, the documents of the Commission were circulated universally and the treatment of legal issues in the draft chapters under discussion was considerably more detailed than the treatment of such issues in the ECE guide. It was suggested that in its work on the legal guide the Commission should take into consideration solutions adopted in the ECE guide.

4. The Commission was agreed that the legal guide to be prepared should not formulate rules and instructions to be followed in drawing up countertrade transactions. Rather, it should provide an analysis of legal issues that arose in international countertrade transactions, provide possible contractual solutions to such issues and give guidance as to the implications of the various solutions.

5. It was suggested that the legal guide should address the question of the legal rules applicable to contracts involved in a countertrade transaction and in that context it should discuss the applicability of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980) (hereafter referred to as "United Nations Sales Convention").

6. Suggestions were made to facilitate the use of the legal guide by such means as a chapter summary at the beginning of each chapter, a subject-matter index, check-lists of contractual issues that should be borne in mind by the parties, graphic illustrations and illustrative contract provisions. It was suggested that illustrative contract provisions and graphic illustrations could be provided at the next stage of preparing draft chapters, whereas the summaries, index and check-lists should be prepared at a later stage of the work.

7. The Commission was of the view that the structure of the legal guide as set out in paragraph 6 of A/CN.9/332 was acceptable.

#### I. INTRODUCTION TO LEGAL GUIDE

(A/CN.9/332/Add.1)

8. The Commission noted that the legal guide would have an introductory chapter describing the origin, purpose, approach and structure of the guide and that that chapter would be drafted at a later stage.

#### II. SCOPE AND TERMINOLOGY OF LEGAL GUIDE

(A/CN.9/332/Add.1)

##### A. Transactions covered

9. It was noted that the description in paragraph 1 of draft chapter II of the transactions to be covered in the legal guide was not intended to serve as a definition of countertrade, but rather to delimit the scope of the legal guide. It was suggested that the term "international contractual arrangements" as used in paragraph 1 to refer to countertrade transactions might be understood as limiting the scope of the legal guide to contracts that were enforceable. It was suggested that the description should make it clear that the legal guide covered also commitments that

might not be enforceable as contracts. (As to the discussion on the types of commitments to be dealt with in the legal guide, see para. 24 below.)

10. The view was expressed that paragraph 1 of the draft chapter should mention the economic reasons that parties frequently had for engaging in countertrade. The prevailing view was that the legal guide was not an appropriate place for such a discussion. There was support for the view that paragraph 1 should give a clearer indication that the reference to "goods" was intended to refer not only to manufactured goods but also to raw materials. A related suggestion was that section B of draft chapter II should be expanded to provide definitions of terms such as "goods" and "technology" that appeared frequently in the draft legal guide.

11. It was suggested that paragraphs 2 to 7 of draft chapter II, which described the differing features of countertrade transactions, should be made more concise. In particular, it was suggested that paragraph 5 could be deleted so as to avoid a discussion of economic reasons for engaging in countertrade transactions. According to that view, mention could be made of the potential contractual implications of differing degrees of interest of the parties at relevant points in the legal guide. Another view was that the limited reference to economic factors in paragraph 5 was useful to explain that the economic position of the parties might affect the negotiation and drafting of contractual provisions.

### B. Terminology

12. The Commission noted that the purpose of section B.1 of draft chapter II was not to provide a precise delimitation of the scope of the legal guide or to provide an exhaustive list of the commercial types of countertrade transactions, but to establish a terminology that would be used when the discussion in the legal guide was relevant to a particular type of countertrade. Possible improvements discussed by the Commission included a suggestion that a clearer distinction should be drawn between counterpurchase and offset and a suggestion that the definition of offset in paragraph 13 of the draft chapter should indicate clearly that the legal guide would generally not focus on the commitment of a party to the transaction to make an investment.

13. The view was expressed that the terminology in section B.2 of draft chapter II should be based on the assumption that in countertrade transactions one of the parties, or its Government, typically required the other party to accept a countertrade commitment. The prevailing view was that the existing terminological approach in the draft legal guide was preferable because terminology based on such an assumption would draw the legal guide into a discussion of underlying economic factors and because the distinction that such an assumption would introduce would not be particularly useful in describing the legal issues considered in the legal guide.

14. It was decided to align the description of the term "countertrade agreement" as it appeared in paragraph 19 of draft chapter II with the decision of the Commission concerning the types of countertrade commitments on which the legal guide should focus (see para. 24 below).

15. There was support for a suggestion that paragraph 23 of the draft chapter defining the concept of "countertrade transaction" should make clear that the sources of the rights and obligations of the parties were the countertrade agreement and the supply contracts. It was suggested that the definition of "countertrade transaction" should precede the definition of "countertrade agreement" in paragraph 19 of the draft chapter.

### C. Focus on issues specific to countertrade

16. The Commission was in agreement with the approach outlined in section C of draft chapter II, namely, that the legal guide should focus on issues specifically relevant to drawing up countertrade agreements.

### D. Governmental regulations

17. It was noted that paragraph 27 of draft chapter II made a useful distinction between governmental regulations specific to countertrade and governmental regulations of a more general character that were applicable to countertrade transactions. The view was expressed that an illustrative list of such generally applicable regulations (e.g., export regulations, customs requirements and competition law) would be helpful. The Commission agreed that chapter XIV, "Choice of law", was the appropriate place for a more extensive discussion on that point. A suggestion to include in the legal guide a section indicating which States required their nationals to resort to countertrade was not adopted.

## III. CONTRACTING APPROACH

(A/CN.9/332/Add.2)

### A. Choice of contract structure

18. While it was understood that the legal guide was not intended to provide guidance to parties on obtaining trade financing, the Commission agreed that the legal guide should indicate that the choice of a particular contractual structure might affect the ability of a party to obtain financing or export credit insurance. That would be the case, for example, where a trade financing institution would hesitate to finance the shipment in one direction or insure payment claims arising from the shipment if it appeared that the payment for that shipment might be affected by circumstances involving a shipment in the other direction. Such an indication could be placed in paragraph 1 as well as at other relevant points in draft chapter III.

19. The deliberations by the Commission on paragraphs 8 and 9 of draft chapter III indicated that the description of a merged contract needed to be made more precise. It was suggested that the second sentence of paragraph 9 should make it clear that non-delivery, refusal to take delivery and non-payment were examples of non-performance of a contract. It was further suggested that the legal guide should address the possible effects of various types of non-performance of a contract obligation on other contract obligations.

20. The Commission was of the view that additional clarity and alignment of language was desirable in paragraphs 9 and 17 of draft chapter III where the impact of the choice of contractual approach on the interdependence of the obligations of the parties was discussed. It was generally felt necessary to emphasize that the applicable law might be uncertain on that point and that it was therefore advisable for the parties to express clearly the desired degree of interdependence.

21. The Commission noted that the advice in paragraph 13 of draft chapter III concerning the desirability of setting out to the extent possible the terms of the future supply contract in the countertrade agreement was not intended to be a statement of legal doctrine concerning the enforceability of the countertrade commitment or of the essential elements of a countertrade agreement. It was a statement of the commercial reality that the more the terms of the future contract were set out in the countertrade agreement, the more likely it was that the parties would successfully conclude the supply contract in the future.



22. The Commission was agreed that a statement should be added to paragraph 13 of draft chapter III that the time period in which the supply contract should be concluded was one of the potentially important elements to be settled in the countertrade agreement.

23. It was suggested that the meaning of the expression "mechanisms for monitoring and recording the level of trade" in paragraph 19 of draft chapter III should be clarified.

#### B. Contents of countertrade agreement

24. In reviewing paragraph 22 of draft chapter III, the Commission considered whether the legal guide should focus only on those countertrade agreements that contained a firm commitment to conclude a future contract or whether the legal guide should also discuss countertrade agreements containing a lower degree of commitment (e.g., a commitment merely to negotiate or to exercise "best efforts" to conclude a supply contract). In support of the broader approach, it was stated that in practice commitments of the "best efforts" type were used and that guidance should be given to the parties as to the implications of such commitments. The prevailing view, however, was that the legal guide should focus on countertrade agreements involving a firm countertrade commitment. In support of the narrower approach it was said that only firm commitments raised the kinds of issues that should be discussed in the legal guide. It was noted that one of those issues might be whether a given commitment, though firm, was legally enforceable (see para. 9 above). The Commission also noted that a focus on firm commitments would be in line with the approach taken in the ECE guide.

25. It was noted that paragraphs 22 to 33 of draft chapter III served as a listing of possible issues to be dealt with in the countertrade agreement and that a more extensive discussion would be found in the chapters devoted to the individual issues. Suggestions were made that section B of draft chapter III should refer to the question of the legality of penalty clauses and of clauses restricting the right of a purchaser to resell the countertrade goods. It was suggested that the parties should be encouraged in paragraph 32 to agree on the law applicable to the countertrade agreement and to the future supply contracts.

#### C. Countertrade commitment

26. It was noted that paragraphs 37 to 42 of draft chapter III would have to be reviewed in the light of the decision to focus on countertrade transactions involving a firm commitment to enter into supply contracts (see para. 24 above).

27. As to the second sentence of paragraph 46 of draft chapter III, it was stated that the legal guide should not suggest either that a supply contract would necessarily have to be signed to be enforceable or that an additional written instrument would necessarily be required where the parties already agreed in the countertrade agreement on the essential terms of the future supply contract.

28. In the discussion of paragraph 61 of draft chapter III, the view was expressed that the legal guide should discourage clauses in the countertrade agreement empowering one of the parties to determine a term of one of the supply contracts. It was said that such clauses would not be recognized in some legal systems. The prevailing view was that the legal guide should, with an appropriate *caveat*, address such clauses since they were used in certain circumstances. It was suggested that the conditions under which such clauses would be valid in some legal systems should be expressed more clearly. It was also suggested that the term "arbitrary" in the third sentence of paragraph 61 should be replaced by the term "unilateral".

### IV. GENERAL REMARKS ON DRAFTING

(A/CN.9/332/Add.3)

29. The Commission noted that draft chapter IV, while generally not containing information specific to countertrade contracts, would be useful to practitioners drawing up countertrade contracts. It was also noted that the draft chapter was modelled on a similar chapter contained in the *UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works* (A/CN.9/SER.B/2, United Nations Publication, Sales No. E.87.V.10).

#### A. General remarks

30. It was suggested that paragraph 3 of draft chapter IV should urge the parties to conclude countertrade contracts in writing. It was further suggested that the last sentence of paragraph 3 needed to be aligned with article 29(2) of the United Nations Sales Convention so as to avoid suggesting that oral modifications were necessarily invalid when the parties had agreed that modifications should be in writing.

31. The view was expressed that the parties should be urged to clarify the relationship between contract documents on the one hand and oral exchanges, correspondence and draft documents on the other. It was also suggested that the last sentence of paragraph 4 of draft chapter IV, concerning the significance of oral exchanges and correspondence, needed to be redrafted in order to take account of article 8 of the United Nations Sales Convention. Another suggestion was that paragraph 4 might be superfluous in view of paragraph 5 of draft chapter IV.

32. It was suggested that a reference should be made in paragraph 6 of draft chapter IV to the advisability of specifying the applicable law in the countertrade agreement.

33. A view was expressed that paragraph 8 of draft chapter IV concerning introductory recitals should be deleted because the legal guide should encourage countertrade parties to draft clear contractual terms and not to rely on recitals to interpret unclear terms. The prevailing view was that the paragraph should be retained. In support of that view it was stated that introductory recitals might be useful in interpreting the terms of the contract. It was suggested that the significance of various kinds of statements that might be made in introductory recitals should be explained.

#### B. Language

34. The Commission agreed with a proposal that paragraph 11 of draft chapter IV should be expanded to advise parties to consider the languages in which annexes to the countertrade agreement (e.g., technical specifications) were to be drawn up and to agree in advance on who would pay for any translations that might be necessary. It was pointed out that such annexes were often lengthy and that it might be appropriate for the annexes to be in a language other than that of the countertrade agreement.

#### C. Parties to transaction

35. It was suggested that paragraph 14 of draft chapter IV should point out that special formalities for the conclusion of a countertrade agreement or of a supply contract might be required if one of the parties was a governmental agency. It was also suggested that the legal guide should advise parties negotiating with governmental agencies to pay attention to the question of a dispute settlement clause, including the question of a waiver of sovereign immunity and consent to arbitration.

### D. Notifications

36. An additional issue proposed for coverage in section D of draft chapter IV was the place to which notifications were to be sent.

### E. Definitions

37. A proposal was made that the legal guide should make a stronger recommendation than that currently made in the first sentence of paragraph 19 of draft chapter IV that the countertrade agreement should define key expressions or concepts used in the countertrade agreement itself or to be used in the supply contracts.

## V. TYPE, QUALITY AND QUANTITY OF GOODS

(A/CN.9/1332/Add.4)

### A. General remarks

38. The Commission suggested that the third sentence of paragraph 1 of draft chapter V should be revised in line with the observation made in respect of paragraph 13 of draft chapter III (see para. 21 above).

### B. Type of goods

39. There was support in the Commission for a suggestion that section B of draft chapter V should make appropriate mention of special issues raised when the subject-matter of the countertrade commitment was technology or services.

40. It was suggested that paragraphs 2 and 3 of draft chapter V should make clear that they addressed only governmental restrictions specific to countertrade applicable at the time of the conclusion of the countertrade agreement. Those restrictions involved in particular the kinds of goods that were eligible to be offered in countertrade transactions. It was further suggested that the legal guide should alert negotiators to the possibility that restrictions of a general character concerning the export or import of goods could affect the contractual freedom of parties to a countertrade transaction. With respect to the effect of restrictions imposed after the parties had agreed on the type of goods, it was proposed that a cross-reference should be added to draft chapter XIII, where it was intended to treat the impact of such restrictions on the countertrade transaction.

41. A related suggestion was that the legal guide should advise the parties that in certain circumstances (e.g., transactions involving the transfer of technology) they might wish to ensure, prior to the initiation of the countertrade transaction, that any required export licences were obtainable. Such advice was said to be appropriate because the denial of an export licence in the context of countertrade could pose greater difficulties than a similar denial in a simple sales transaction.

42. It was suggested that the third sentence of paragraph 3 of draft chapter V was unnecessary because there was no need to reflect in the countertrade agreement mandatory restrictions on origin and source of countertrade goods.

### C. Quality of goods

43. It was observed that a reference in a countertrade agreement to quality standards prevailing in a particular market or

country, as described in paragraph 13 of draft chapter V, might involve mandatory regulations, non-mandatory regulations and trade usages. It was suggested that the implications of such references to quality standards should be taken into account in revising section C of draft chapter V.

44. It was suggested that paragraph 14 of draft chapter V should be redrafted so as to make clear that it dealt with the drafting of a provision in the countertrade agreement prior to the conclusion of supply contracts.

45. The Commission noted that the quality control referred to in section C.2 of draft chapter V was specific to countertrade in that it involved determining whether goods being offered for purchase conformed to quality standards set out in the countertrade agreement, rather than determining whether goods delivered pursuant to a supply contract conformed to the quality provisions of the supply contract. Quality control pursuant to a supply contract raised questions of sales law not specific to countertrade. The suggestion was made that, notwithstanding the focus of section C.2 of draft chapter V, the possibility of a pre-shipment inspection following the conclusion of the supply contract should be mentioned in paragraph 15 of draft chapter V.

46. As to the last sentence of paragraph 15 of draft chapter V, it was suggested that there should be taken into account the cases in which only some of the shipments of goods of a given type were subject to pre-contractual quality control.

47. The suggestion was made that paragraph 17 of draft chapter V should recommend to the parties that they should agree on inspection procedures and on a quick process for resolving disputes that might arise with respect to an inspector's findings. It was also suggested that the paragraph might include an explicit reference to quality arbitration.

48. In the discussion of paragraph 18 of draft chapter V concerning the effect of the inspector's finding, it was suggested that parties should be advised to deal in the countertrade agreement with the time-frame for quality control and with the notification to the parties of the results of the quality control. It was also suggested that the third sentence of the paragraph should be redrafted in order to avoid giving the impression that the inspector's report alone could result in a supply contract, absent the agreement of the parties on all of the essential terms of the supply contract. A further suggestion was that paragraph 18 should mention the possibility that the parties might agree that a negative finding would release the party committed to purchase from the countertrade commitment.

### D. Quantity of goods

49. It was noted that the question of the extent of the countertrade commitment, mentioned in paragraph 20 of draft chapter V, would be more extensively discussed in the revised draft chapter III, "Contracting approach". Questions to be discussed in draft chapter III included contractual methods of determining the "countertrade ratio", i.e., the ratio between the values of the shipments in the two directions.

50. Interest was expressed in expanding paragraphs 26 and 27 of draft chapter V concerning additionality. The expanded paragraphs might, for example, address the question of whose purchases would be counted, provide illustrative provisions and give examples of the types of sources that could be used to obtain the trade volume information referred to in paragraph 27.

## VI. PRICING OF GOODS

(A/CN.9/332/Add.5)

### A. General remarks

51. It was suggested that paragraph 1 of draft chapter VI should be modified to make clear that in some countertrade transactions the price setting mechanism established in the countertrade agreement was used to set the price for the supply of goods in both directions. It was suggested that the reference in paragraph 4 of draft chapter VI should be to the latest version of the INCOTERMS of the International Chamber of Commerce. With respect to paragraph 6 of draft chapter VI, it was proposed that the reference should be to an "anti-dumping import duty", in order to portray more accurately the typical approach. In regard to paragraph 8 of draft chapter VI, it was stated that the term "convertible currency" would be more appropriate than "foreign currency".

### B. Currency of price

52. The Commission approved the approach taken in section B of draft chapter VI.

### C. Determining price after conclusion of countertrade agreement

53. It was suggested that section C of draft chapter VI should take into account questions encountered in the specific contexts of technology transfer and rendering of services.

54. The suggestion was made that it should be made clear that paragraphs 21 to 24 of draft chapter VI related to the particular case of a countertrade agreement containing a commitment to conclude a future contract rather than to contract negotiations in general.

55. It was stated that, if a countertrade party expected a supply contract in one direction not to be profitable, that party normally wished to offset the expected loss when the price for the contract in the other direction was negotiated. It was suggested that such a possibility should be reflected in describing the negotiating process in draft chapter VI.

56. The Commission agreed that paragraph 26 of draft chapter VI should stress the importance of providing guidelines to delimit the mandate of a third person entrusted with the determination of price.

57. Views were expressed that the legal guide should warn the parties that determination of the price by one party, as described in paragraph 27 of draft chapter VI, was not admitted in some legal systems and that such a price setting device could lead to disputes as to the enforceability of the contract. The Commission noted that the substance of the draft paragraph would be aligned with paragraph 61 of draft chapter III to be revised in accordance with the discussion reflected above (see para. 28 above).

58. It was suggested that the legal guide should point out that price setting by negotiation (section C.2 of draft chapter VI) and determination of price by a third person (section C.3 of draft chapter VI) could be combined in a countertrade agreement into a cumulative approach so that the determination of price would be entrusted to a third person in the event that the parties failed to negotiate a price.

### D. Revision of price

59. The Commission noted that section D of draft chapter VI did not address situations of hardship, namely, when a change in economic, financial, legal or technological factors caused serious adverse economic consequences to a contracting party, thereby rendering more difficult the performance of the contractual obligations. The Commission noted that it was intended to discuss hardship clauses in a general manner in draft chapter XIII. In that connection, the view was expressed that any such discussion should include a warning that the use of hardship clauses might cause difficulties, an approach similar to the one taken in the UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works.

60. It was suggested that paragraph 34 of draft chapter VI should indicate that index clauses could be formulated so as to link the price of the goods to be delivered in the countertrade transaction to the cost of raw materials used in the production of the goods.

## IX. PAYMENT

(A/CN.9/332/Add.6)

### A. General remarks

61. The view was expressed that paragraph 1 of draft chapter IX should express a preference for linked payment mechanisms. The prevailing view was that the legal guide should not make a general recommendation in that regard because the appropriateness of linking payment for the shipments in the two directions depended on the circumstances of each individual countertrade transaction. It was considered appropriate to refer to the implications of linked payment mechanisms for the ability of the parties to obtain financing or credit insurance (see para. 18 above). It was also suggested that the relevance of linked payment mechanisms to various commercial types of countertrade should be discussed in the legal guide.

### B. Retention of funds by importer

62. It was suggested that the word "returned" in the last sentence of paragraph 9 of draft chapter IX was not appropriate because the funds retained by the importer were never actually in the possession of the exporter.

63. Regarding the discussion in paragraph 10 of draft chapter IX on interest earned on funds retained by the importer, it was suggested that the question of which of the parties was to receive the interest should be addressed.

### C. Blocking of funds

64. It was proposed that more details on the use of negotiable instruments should be added to paragraph 32 of draft chapter IX.

### D. Setoff of countervailing claims for payment

65. It was pointed out that in some States setoff arrangements were subject to governmental authorization and that mention of that fact might be made in section D of draft chapter IX.

66. The view was expressed that the last sentence of paragraph 35 of draft chapter IX should be modified so as to avoid giving the impression that the only way an imbalance in the values of the shipments in the two directions could be settled would be by payment of money and not, for example, by delivery of additional goods.

67. It was proposed that section D of draft chapter IX should mention that the legislation of some States recognized setoff accounts as a distinct type of contract and that specific non-mandatory rules were applicable to fill gaps in the contract established by the parties. Terms used for such setoff accounts included "*cuenta corriente*", "*Kontokorrent*" and "*conto corrente*". Furthermore, it was pointed out that the possibility to set off claims under the contract might be affected by the bankruptcy of one of the parties.

68. As regards paragraph 44 of draft chapter IX, it was suggested that the reference to the Uniform Customs and Practice for Documentary Credits (UCP) should be reworded in view of the fact that banks customarily incorporated UCP into their letter of credit forms.

69. It was suggested that the meaning of paragraphs 50 and 51 of draft chapter IX concerning the settlement of an imbalance that remained at the conclusion of the period for the fulfilment of the countertrade commitment or at the conclusion of subperiods within that period should be clarified.

## XII. SECURITY FOR PERFORMANCE

(A/CN.9/332/Add.7)

### A. General remarks

70. It was suggested that paragraph 1 of draft chapter XII should make clear that the countertrade agreement might provide that the party committed to supply goods, as well as the party committed to purchase goods, was to obtain a guarantee to secure fulfilment of the countertrade commitment. The view was expressed that the second sentence of paragraph 4 of draft chapter XII should be deleted.

### B. Guarantee provisions in countertrade agreement

71. It was pointed out that the last sentence of paragraph 9 of draft chapter XII might be misread as suggesting that in all circumstances, absent a contractual provision to the contrary, the principal would remain liable upon payment under the guarantee. Reference was made during the discussion of the paragraph to the rule in many legal systems that additional damages beyond the guarantee amount might be recoverable. It was further suggested that the paragraph should not imply that the principal had a choice either to fulfil the underlying contractual obligation or to have the guarantee amount paid.

72. The suggestion was made that a discussion of the use of counter-guarantees should be added to paragraph 13 of draft chapter XII.

73. With regard to paragraph 16 of draft chapter XII, the view was expressed that simple demand guarantees, owing to their controversial nature, should not be mentioned in the legal guide in order to avoid encouraging the use of such guarantees. The prevailing view was that the legal guide had to mention such guarantees because of the extent of their use in countertrade, though a warning should be included concerning the potential for abuse. It was recommended that, in formulating the provisions in the legal guide concerning simple demand guarantees, account should be taken of the preparatory work on a uniform law on guarantees being carried out by the Commission's Working Group on International Contract Practices.

74. The view was expressed that the legal guide should call attention to the existence in some legal systems of mandatory rules governing the validity period of guarantees.

## ANNEX II

### Convention on the Limitation Period in the International Sale of Goods as amended by the Protocol amending the Convention on the Limitation Period in the International Sale of Goods

(proposed Arabic language version)

(The proposed Arabic language version of the Convention is reproduced only in the Arabic language version of the present report. For the discussion in the Commission, see paragraphs 63 and 64 of the report.)

## ANNEX III

### List of documents before the Commission at its twenty-third session

[Annex reproduced in part three, II, A, of this volume.]

**B. United Nations Conference on Trade and Development (UNCTAD):  
extract from the report of the Trade and Development Board on the first  
part of its thirty-seventh session (TD/B/1277 (Vol. II))\***

"D. *Progressive development of the law of international trade: twenty-third annual report of the United Nations Commission on International Trade Law*

"(Agenda item 8 (d))

"468. At its 775th meeting, the Board took note of the report of the United Nations Commission on Interna-

tional Law on the work of its twenty-third session (A/45/17), which had been submitted to the Board for comment (under the cover of TD/B/1269) in pursuance of General Assembly resolution 2205 (XXI), section II, paragraph 10."

*\*Official Records of the Trade and Development Board, Thirty-seventh Session, First Part, Supplement No. 1A (Part I).*

**C. General Assembly: report of the United Nations Commission on  
International Trade Law on the work of its twenty-third session: report  
of the Sixth Committee (A/45/736)**

**I. INTRODUCTION**

1. The item entitled "Report of the United Nations Commission on International Trade Law on the work of its twenty-third session" was included in the provisional agenda of the forty-fifth session of the General Assembly pursuant to General Assembly resolution 44/33 of 4 December 1989.

2. At its 3rd plenary meeting, on 21 September 1990, the General Assembly, on the recommendation of the General Committee, decided to include the item in its agenda and to allocate it to the Sixth Committee.

3. In connection with the item, the Sixth Committee had before it the report of the Commission,<sup>1</sup> which was introduced by the Chairman of the Commission at the 3rd meeting of the Sixth Committee, on 24 September 1990.

4. The Sixth Committee considered the item at its 3rd to 5th and 43rd meetings, from 24 to 25 September and on 16 November 1990. The summary records of those meetings (A/C.6/45/SR.3-5 and 43) contain the views of the representatives who spoke on the item.

<sup>1</sup>Official Records of the General Assembly, Forty-fifth Session, Supplement No. 17 (A/45/17).

**II. CONSIDERATION OF DRAFT RESOLUTION**

5. At the 43rd meeting, on 16 November, the representative of *Austria* introduced a draft resolution entitled "Report of the United Nations Commission on International Trade Law on the work of its twenty-third session" (A/C.6/45/L.10), sponsored by *Argentina, Australia, Austria, Brazil, Byelorussian Soviet Socialist Republic, Chile, Cyprus, Czechoslovakia, Denmark, Egypt, Finland, France, Germany, Greece, Guatemala, Hungary, Italy, Kenya, Lesotho, Libyan Arab Jamahiriya, Morocco, Netherlands, Poland, Spain, Sweden, Turkey, Venezuela* and *Yugoslavia*, later joined by *Bahrain, Canada, Myanmar* and *Thailand*.

6. At the same meeting, the Committee adopted draft resolution A/C.6/45/L.10 without a vote (see para. 7).

**III. RECOMMENDATION OF THE SIXTH  
COMMITTEE**

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

[Text not reproduced in this section. The draft resolution was adopted, with editorial changes, as General Assembly resolution 45/42 (see part D, below).]

**D. General Assembly resolution 45/42 of 29 January 1991**

45/42. *Report of the United Nations Commission on International Trade Law on the work of its twenty-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, as well as its resolutions 43/166 of 9 December 1988 and 44/33 of 4 December 1989,

# I. INTERNATIONAL PAYMENTS

## A. Report of the Working Group on International Payments on the work of its nineteenth session

(New York, 10-21 July 1989) (A/CN.9/328) [Original: English]

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### INTRODUCTION

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

2. The Working Group undertook the task at its sixteenth session (Vienna, 2-13 November 1987), at which it

considered a number of legal issues set forth in a note by the Secretariat. The Group requested the Secretariat to prepare draft provisions based on the discussions during its sixteenth session for consideration at its seventeenth session. At its seventeenth session (New York, 5-15 July 1988) the Working Group considered the draft provisions prepared by the Secretariat. At the close of its discussions the Working Group requested the Secretariat to prepare a revised draft of the Model Rules. At its eighteenth session (Vienna, 5-16 December 1988) the Working Group began its consideration of the redraft of the Model Rules, which it renamed the draft Model Law on International Credit Transfers.

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

3. The Working Group held its nineteenth session in New York from 10 to 21 July 1989. The Group was composed of all States members of the Commission. The session was attended by representatives of the following States members: Argentina, Cameroon, Canada, China, Costa Rica, Czechoslovakia, Denmark, Egypt, France, Germany, Federal Republic of, Hungary, India, Iran (Islamic Republic of), Iraq, Italy, Japan, Kenya, Lesotho, Mexico, Morocco, Netherlands, Nigeria, Singapore, Spain, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United States of America, Uruguay and Yugoslavia.

4. The session was attended by observers from the following States: Australia, Austria, Finland, German Democratic Republic, Ghana, Guinea-Bissau, Indonesia, Israel, Peru, Poland, Republic of Korea, Saudi Arabia, Swaziland, Sweden, Switzerland, Thailand, Uganda, United Republic of Tanzania, Vanuatu, Venezuela and Zaire.

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

6. The Working Group elected the following officers:

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

*Rapporteur:* Mr. Bradley Crawford (Canada)

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

(a) Provisional agenda (A/CN.9/WG.IV/WP.40);

(b) International Credit Transfers: Comments on the draft Model Law on International Credit Transfers, report of the Secretary-General (A/CN.9/WG.IV/WP.41);

(c) International Credit Transfers: Major issues to be considered by the Working Group, report of the Secretary-General (A/CN.9/WG.IV/WP.42).

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

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

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

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

9. The Working Group adopted the following agenda:

(a) Election of officers.

(b) Adoption of the agenda.

(c) Consideration of draft provisions for Model Law on International Credit Transfers.

(d) Other business.

(e) Adoption of the report.

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

10. The text of the draft Model Law before the Working Group was that set out in the report of the eighteenth session of the Working Group (A/CN.9/318, annex) and reproduced with comments in A/CN.9/WG.IV/WP.41.

### A. Acceptance

11. The Working Group began its work by considering the concept of "acceptance" as discussed in A/CN.9/WG.IV/WP.42. It first turned to paragraph 7 of that document, which considered the obligations of notification incumbent on a receiving bank that decided not to accept a payment order it had received.

#### I. Article 5

##### Paragraph (1)

12. The view was expressed that article 5, and particularly paragraph (1), placed too heavy a burden on the receiving bank. A receiving bank would normally execute a payment order that it had received. Therefore, if it decided not to execute such an order, there would normally be a reason that was associated with its sender. Rather than place a burden on the receiving bank to notify its sender that it would not execute the order, the Model Law should provide that it was the sender's obligation to choose an appropriate receiving bank.

13. Under another view, the obligation that article 5(1) placed on the receiving bank to notify its sender that it would not execute a payment order it had received increased the security of the credit transfer system. Neither the originator nor a sending bank should have to make a telephone call to a receiving bank or to the beneficiary's bank to inquire whether the payment order had been executed. They should be able to rely on the assumption that the transfer was being carried out properly unless the receiving bank had not been furnished with sufficient funds to pay for the order or they had been informed that the order would not be executed.

14. It was stated that there was no reason to require the sender and the receiving bank to have had a prior relationship for the obligation of notification to arise, since the obligation did not arise in any case unless sufficient funds to pay for the order had been furnished to the receiving bank. Under another view, the receiving bank should be required to notify in all cases that it would not execute a payment order it had received. It was pointed out that article 5(1 *bis*) required the receiving bank to give notice

that it had received a misdirected payment order even though in most cases the receiving bank would not have received funds to pay for the order.

15. The question was raised as to what was meant by the words "insufficient funds". It was suggested that when the Working Group had adopted the current text of article 5(1) at its eighteenth session it had had in mind the case of the originator who did not have a sufficient account balance to pay for the payment order. It was suggested that further consideration should be given to whether there were insufficient funds in situations such as those in which the reimbursement to a receiving bank had been reduced by service fees, notice of credit to the receiving bank's account with a third bank had not yet been received or the receiving bank was not willing to accept reimbursement by credit to its account in a particular third bank. While the receiving bank would not be required to execute the payment order, it could be questioned whether in cases of that nature it should not be required to give notice of its failure to execute the payment order.

16. After deliberation, the Working Group decided to retain paragraph (1) as drafted subject to later reconsideration.

#### *Paragraph (1 bis)*

17. It was observed that in many, if not most, of the occasions when a misdirected payment order was received, the receiving bank would not receive funds to pay for that order. It was said to be an anomaly that a receiving bank should have to notify the sender of the receipt of such a payment order since it was not required to notify the sender that it would not execute a properly addressed payment order for which there was insufficient funds. In reply it was stated that every system needed appropriate mechanisms to correct errors that occurred. The operational burden placed on the receiving bank by paragraph (1 bis) was said not to be unduly burdensome.

18. Concern was expressed over the fact that the duty stated in paragraph (1 bis) was stated objectively. It was pointed out that banks that were potentially subject to the Model Law had widely differing degrees of sophistication and some of them might not readily recognize that the payment order had been misdirected.

19. A similar concern was that the receiving bank should be required to notify the sender only if the identity of the sender and its address could be readily ascertained. It was said that this was likely to be a problem only if the sender was not a bank and only if the payment order was on paper, since electronic funds transfer systems would not permit the transmission of the message unless the proper identification of the sender was included. It was also said that it was not necessary to include any such qualification on the duty to notify because it was self evident that the receiving bank could not be required to notify the sender if the sender could not be identified.

20. After discussion, the Working Group decided to add words such as "and contains sufficient information to identify and trace the sender".

21. The Working Group noted that the financial consequences to the receiving bank for failure to give the required notice were set forth in paragraph (1 bis) in square brackets so that they might be moved to article 9 at an appropriate time. The Working Group engaged in a discussion as to whether the consequences as there set forth were appropriate.

22. There was general agreement that the receiving bank should pay to the sender interest on the funds received for the period of time the receiving bank was in possession of those funds as provided in subparagraph (a). It was noted that the remedy was by its nature one of restoring to the sender that which it had lost and the receiving bank had gained by virtue of the receiving bank's failure to give the required notice. In this respect it was noted that the receiving bank might not have been in a position to invest the funds if they were of a substantial nature and they had been received at the end of the funds' transfer day. It was also suggested that the receiving bank should be required to pay the interest only if the loss to the sender was due to the receiving bank's delay in notifying the sender of the misdirection and the funds were in usable form.

23. After discussion, the Working Group decided to retain subparagraph (a) without change.

24. Under one view, subparagraph (b) operated as a penalty and should be deleted. It was stated that if the receiving bank had not had the use of any funds it should not have to pay the sender any interest. Under another view, the receiving bank that failed to notify the sender of the misdirected payment order should be liable for the loss that had occurred, and subparagraph (b) operated as a limit of liability.

25. In connection with the view that the receiving bank should not have to pay interest if it had not had the use of any funds, it was suggested that the receiving bank should be obligated to give notice of the misdirected payment order only if it had been supplied with funds.

26. It was decided that subparagraph (b) should be retained at present and should be reconsidered when the liability provisions of article 9 were considered.

## 2. Article 6

27. The Working Group noted that at its eighteenth session it had "agreed to reconsider the question [of the usefulness of the concept of acceptance] at a later time when the consequences of 'acceptance' of a payment order might be seen more clearly and the Working Group might have been sufficiently enlightened in regard to the concept in order to decide whether it would be convenient to retain or to abandon it." (A/CN.9/318, para. 129) The Working Group noted that a discussion of the concept and its consequences had been included in a report of the Secretary-General on major issues in the draft Model Law (A/CN.9/WG.IV/WP.42, paras. 2-42). The Working Group decided that it would consider the concept as it appeared in the draft of the Model Law before it decided whether to retain its use or to abandon it.



*Paragraph (1)*

28. It was stated that the situations described in paragraph (1) did not really constitute an acceptance by the receiving bank. If the concept of acceptance was to be retained in the Model Law, paragraph (1) should state that the receiving bank was deemed to have accepted a payment order in the described situations.

29. A proposal was made that, in addition to the situations described in subparagraphs (a) and (b), paragraph (1) should provide for the possibility of an express acceptance of the payment order by the receiving bank. In opposition it was questioned whether receiving banks accepted payment orders in express terms. In reply it was stated that an unsolicited express acceptance was unlikely but that in the case of a large transfer a bank might be asked whether it would be prepared to handle the transaction. Its agreement could be understood to constitute an express acceptance of the payment order.

30. A discussion took place as to what would constitute an express acceptance. It was stated that it should be clear that the mere acknowledgement of receipt of a payment order would not be considered to be an acceptance of it. Questions were raised as to whether an acceptance would have to be in writing or whether it could be oral and as to whether an express acceptance could be conditional.

31. It was decided that paragraph (1) should provide for the possibility that a receiving bank that was not the beneficiary's bank could expressly accept a payment order. Consequently, the Working Group decided to add a new subparagraph (c) providing that a receiving bank accepts a payment order "when it sends notice that it will execute the sender's payment order".

32. During its consideration of paragraph (1) the Working Group decided that an express acceptance should relate to one or more specific payment orders and that an agreement to accept all payment orders sent by one or more specified senders would not be considered to be an express acceptance of those orders when they were received by the bank. Subsequently, in connection with its consideration of acceptance of a payment order by the beneficiary's bank, the Working Group decided to include a provision that, when the sender and the receiving bank had agreed that the bank would execute payment orders received from the sender without notification that cover was in place, the payment order would be accepted upon its receipt (see paragraph 49, below).

33. The Working Group discussed the nature of the obligations undertaken by a receiving bank that accepted a payment order. Under one view, the obligations of the receiving bank would arise out of the Model Law, i.e., they would be statutory obligations. Under another view, the transaction partook of the classical offer and acceptance for the formation of a contract. While the Model Law might determine the types of actions that would be considered an acceptance and might determine some of the obligations of the parties, the obligations would be contractual in nature.

34. The Working Group noted that if the obligations arising out of the acceptance of a payment order by a receiving bank were considered to be contractual in nature, the principle of the relativity of contracts would normally limit the parties who had rights in respect of those obligations to the direct parties to the contract, whereas if the obligations were statutory in nature, a broader range of parties might have rights in respect of the obligations. Moreover, if the obligations were contractual in nature, the entire body of the law of contract might be applied to those obligations in appropriate circumstances. It was also suggested that if the obligations were contractual in nature, the Model Law should not attempt to establish an exhaustive list of ways in which the offer made by the sender could be accepted by the receiving bank. In reply it was stated that, whether or not the obligations of the sender and receiving bank were considered to be contractual in nature, it was important that the Model Law establish an exhaustive list of the means by which the receiving bank could accept the payment order so as to aid in establishing legal certainty.

*Paragraph (2)**Consequences of acceptance by the beneficiary's bank*

35. Before the Working Group undertook its consideration of the time when the beneficiary's bank accepted a payment order, it discussed the consequences of acceptance. It was noted that the draft of the Model Law before the Working Group provided for a series of consequences in articles 5(4), 7(1)(c), 8(3) and 11(2) that could be characterized as completion of the credit transfer. It was stated that this illustrated the difference between the use of the concept of acceptance in regard to a receiving bank that was not the beneficiary's bank, where acceptance was used only in a technical sense, and its use in regard to the beneficiary's bank, where acceptance led to legal consequences. It was noted in particular that the time when a payment order could no longer be revoked or amended was linked to the retransmission of the order in the case of a receiving bank that was not the beneficiary's bank (article 8(1)) but was linked to acceptance in the case of the beneficiary's bank (article 8(3)). It was also noted that, in the case of a receiving bank that was not the beneficiary's bank, its obligation to its credit party arose when its credit party accepted the payment order sent by the receiving bank (article 4(4)), whereas the obligation of the beneficiary's bank to its credit party, i.e., to the beneficiary, arose when the bank accepted the payment order (article 11(2)).

36. In reply it was stated that there was a basic similarity in the use of the concept of acceptance in regard to the two categories of banks in that in both cases the sender of the payment order became obligated under article 4(4) to pay the receiving bank for the payment order when the receiving bank accepted it, whether or not the receiving bank was the beneficiary's bank.

37. The Working Group discussed the extent to which the Model Law should enter into the civil consequences of a credit transfer. It noted in particular that article 11(1) provided that "unless otherwise agreed by the parties,

payment of a monetary obligation may be made by a credit transfer to an account of the beneficiary in a bank" and that article 11(2) provided that "the obligation of the debtor is discharged ... to the extent of the payment order received by the beneficiary's bank when the payment order is accepted by the beneficiary's bank".

38. Under one view the Model Law should not contain either provision. Article 11(1) was said to be contrary to the legal rule that the creditor of an obligation could always require the obligation to be paid in legal tender; the Model Law should not make a credit transfer into an autonomous means of discharging an obligation. The question was raised as to whether the provision would limit the beneficiary's right to reject a payment to him by means of a credit transfer.

39. In respect of article 11(2), it was said to be inappropriate in a law intended to govern banking transactions; the rules in respect of the discharge of an obligation properly belonged in the law relating to the underlying obligation itself. Moreover, the text of the provision as it was before the Working Group was said to raise many problems. Although some obligations could be partially discharged by payment of a part of the money due, other obligations were indivisible. Furthermore, the law governing the means by which and the extent to which an obligation could be discharged might be that of a State in which neither the originator's bank nor the beneficiary's bank was located.

40. Under another view, it was appropriate for the Model Law to contain provisions governing the discharge of an obligation by credit transfer. It was stated that some States had tax laws that required commercial payments to be made by cheque, credit transfer or other similar means. Many other States had statutory provisions similar to article 11(1), while in yet others the courts recognized that commercial payments were normally made by bank transfers, and if a creditor wished to be paid in legal tender he would have to give the debtor sufficient notice so that the debtor could acquire and transmit the legal tender to the creditor. It was also stated that article 11(1) already recognized that the obligation could not be discharged by credit transfer if otherwise agreed between the parties.

41. In regard to article 11(2) it was stated that the important part of the provision was in respect of the time when the obligation would be discharged. The current rules differed from one country to another, to the detriment of legal certainty in international commercial relations. Moreover, the current rules were based on banking procedures used for paper-based credit transfers, and those rules should be reconsidered in the light of the changes in procedures brought about by modern methods of making credit transfers. It was also stated that once the Working Group had finished its consideration of the time when the beneficiary's bank became obligated to the beneficiary as a result of the transfer, the Working Group should consider whether it would be appropriate for the beneficiary to have a claim both against his bank and against the debtor on the underlying obligation in those cases in which the beneficiary's bank accepted the payment order

prior to the time when the obligation would be discharged under the otherwise applicable rules of law. Conversely, the Working Group should consider whether the beneficiary should be in a position of having a claim against neither his bank nor the debtor on the underlying obligation in those cases when the beneficiary's bank accepted the payment order after the time when the debtor would be discharged on the obligation under the otherwise applicable rules of law. As to the argument that a rule of discharge of the underlying obligation did not belong in a law governing the banking transaction, it was suggested that the Working Group could, if it was thought to be necessary, prepare the appropriate rule on the time of discharge as a separate text.

42. In order to accommodate the suggestion that some obligations were indivisible, it was suggested that the provision on discharge might indicate that the obligation would be discharged to the extent that payment of the same amount of money would discharge the obligation, thereby taking no position as to whether an obligation could be partially discharged.

43. The Working Group agreed that the extensive discussion had helped to clarify the consequences that would follow from an acceptance of a payment order by the beneficiary's bank. It decided to defer any decision in respect of the consequences of acceptance of the payment order by the beneficiary's bank until it had discussed the time when acceptance took place.

#### *Time of acceptance by beneficiary's bank*

44. The Working Group decided that subparagraph (b) and the new subparagraph (c) of paragraph (1), relative to acceptance by failure to give a required notice of rejection and to express acceptance respectively (see paragraph 31, above), should also be applicable to acceptance by the beneficiary's bank.

45. The Working Group recalled that at its eighteenth session it had decided that paragraph (2)(a) should be modified by adding a volitional element on the part of the beneficiary's bank, but that the subparagraph had not been redrafted to reflect that decision for lack of time (A/CN.9/318, para. 137). At the current session the proposal was made that subparagraph (a) should be retained without the addition of any volitional element.

46. In support of the proposal it was stated that contracts between banks that the receiving bank would execute payment orders when received even if funds to pay for the order were not yet available existed both in regard to multilateral net settlement systems and bilateral banking relations. They were entered into to increase the security of the operation of the funds transfer system. While the credit risk for the receiving bank was increased, there was greater assurance that credit transfers would be carried out promptly. The legal security provided by those contractual obligations would be increased if the receiving bank was considered to have accepted the payment order as soon as it was received.

47. In opposition to the proposal it was stated that the contractual obligation should be considered to be an obligation to accept the payment order; it should not be considered to be the basis on which the order was deemed to be accepted when received unless there had been a volitional act of acceptance by the beneficiary's bank in regard to the specific order. In support of that position, it was stated to be improper to base the legal rights and obligations of third parties on a private contract between the beneficiary's bank and its sending bank. Affected third parties might include not only the originator and the beneficiary, but also the creditors of the originator, beneficiary, sending bank or beneficiary's bank if one of those parties should become insolvent after receipt of the payment order by the beneficiary's bank and prior to its execution by the bank. Such a rule would violate the principle of the relativity of contracts. It was also pointed out that a decision had been made in respect of paragraph (1) that such a contractual obligation would not furnish the basis for an acceptance by a receiving bank that was not the beneficiary's bank (see paragraph 32, above).

48. In reply it was stated that inter-bank contracts that structured the credit transfer process had an effect on third parties in spite of the principle of the relativity of contracts. It was important to consider only what that effect should be.

49. After discussion it was decided to retain subparagraph (a) as contained in the text before the Working Group but to delete the words in square brackets. It was also decided to reverse the decision previously made in respect of paragraph (1) (see paragraph 32, above) and to include a similar provision in that paragraph.

50. It was decided to retain subparagraphs (d) and (e) as well as both variants A and C of subparagraph (c), which were to be made into separate subparagraphs.

51. It was suggested that the differences between paragraphs (1) and (2) had been so reduced that it might be possible to combine them into a single paragraph.

### 3. Retention of the concept of acceptance

52. It was suggested on various occasions during the discussion of the concept of acceptance that it would be preferable to use in article 6 words to the effect that the receiving bank would be "bound to execute" the payment order under the described circumstances. In particular, the Working Group considered the draft text prepared by a small working party at its eighteenth session (A/CN.9/318, para. 142) that had not been considered at that session for lack of time. That text used such a formulation. During the discussions the draft text was withdrawn by its sponsors. Following its consideration of the consequences of acceptance of a payment order by a receiving bank as set forth in the draft of the Model Law and the time when the bank should be considered to have accepted it, the Working Group decided to retain the concept.

## B. Insolvency of a bank

53. The Working Group decided to consider the effect on the credit transfer of the insolvency of a bank occurring during the transfer. It used as the basis for its discussion chapter II of the report of the Secretary-General (A/CN.9/WG.IV/WP.42, paras. 43-57).

### 1. Money-back guarantee, article 5(3)(b)

54. It was noted that article 5(3)(b) provided that, where the beneficiary's bank did not accept a payment order consistent with the contents of the payment order issued by the originator, each receiving bank must refund to its sender any funds received from the sender. This money-back guarantee served to protect the originator in particular.

55. While in the normal course of events each sender would recover any payments it had made to its receiving bank, thereby restoring the situation prevailing prior to the commencement of the failed credit transfer, in some cases one of the sending banks might not be able to recover the funds it had paid to its receiving bank because of the intervening insolvency of that bank, or for other similar reasons. The current text of article 5(3)(b) would leave the loss on the sending bank that had dealt with that receiving bank. It was stated that this rule was incorrect, at least where the use of the receiving bank that had become insolvent had been designated by the originator or by a prior bank in the transfer chain. It was suggested that in those cases the originator or the prior bank that had designated the use of the receiving bank that became insolvent should bear the loss.

56. In reply it was stated that originators would be unlikely to know that the designation of a particular intermediary bank to effectuate the transfer would have potential financial consequences, and that consequently such a rule would be inappropriate unless originators were to be educated as to its effect. It was noted that article 5(3)(b) would not apply to the case in which the beneficiary's bank had become insolvent after it had accepted the payment order addressed to it, since the credit transfer would have been completed and the beneficiary would bear any credit risk in regard to its own bank.

57. It was stated that the money-back guarantee would have the consequence that under the bank supervisory law banks would be required to provide capital for the credit risk involved.

58. The Working Group decided to adopt the text of article 5(3)(b) without change.

### 2. Reversibility of credit

59. The Working Group noted that a receiving bank that gave credit to its credit party before it had received payment from its sender undertook a credit risk. One of the ways it could reduce that risk was to delay giving

credit to its credit party until it had itself received payment. While this reduced credit risk to the bank, the systematic use of such a procedure would delay the operations of the credit transfer system to a degree that would likely be considered unacceptable. It was noted that a procedure that was used in some countries to encourage receiving banks to give prompt credit to their credit parties was to permit them to make the credit reversible if the receiving bank did not receive payment from its sender. While such a procedure generally increased the efficiency of the credit transfer system, it did so by placing the credit risk on the receiving bank's credit party. Moreover, it introduced the possibility that the inability of a sending bank to pay all of its receiving banks would have a cascading effect throughout the banking system, as the reversal of provisional credits deprived those credit parties of the funds they had expected to have available to meet their obligations.

60. It was noted that a proposal of a small working party at the eighteenth session of the Working Group that had not been considered at that session for lack of time had anticipated the possibility of the granting of provisional credit (A/CN.9/318, para. 142). It was further noted that, although the proposal had been withdrawn at the current session, no decision of principle had been made in respect of provisional credit at that time (see paragraph 52, above). Moreover, the current draft of the Model Law neither expressly permitted nor prohibited the giving of provisional credit. Nevertheless, the prevailing view in the Working Group was that it was undesirable for a receiving bank, including the beneficiary's bank, to be allowed to reverse a credit.

### 3. Netting

61. The Working Group noted that the report of the Secretary-General suggested that one of the ways in which the credit risk of receiving banks could be reduced prior to receiving payment from the sending bank, thereby encouraging the bank to make credit available to its credit party promptly after receiving a payment order, was to allow it to net its claims against and its obligations to the sending bank. Such a procedure of netting might be of particular importance in a multilateral net settlement system, where the netting might be permitted either bilaterally between pairs of banks or on the basis of the net claims or obligations in regard to the entire group of banks, but it could also be applied bilaterally between banks that settled between themselves periodically outside of any net settlement system.

62. The Working Group engaged in a preliminary discussion of the desirability of introducing a provision on netting into the Model Law. It was stated that in some countries no such provision would be necessary because at least bilateral netting would follow naturally from the general rules on set-off. It was stated that in other countries even bilateral netting might not apply without specific statutory approval, and it was more doubtful whether multilateral netting could be applied without specific statutory approval.

63. In opposition to the introduction of any provision on netting into the Model Law, it was stated that it was unnecessary since the future for large-value credit transfers lay in the direction of prompt payment by senders by credit with the central bank. It was also stated that there were wider public policy issues involved in that, while netting arrangements reduced credit risk for the netting banks, it did so by reducing the amount of assets that might be available for distribution to other creditors of a bank if that bank should become insolvent.

64. The Working Group noted that important studies on netting arrangements by banks were being undertaken by various bodies. In particular, a committee of the central banks of the Group of Ten, presided by the General Manager of the Bank for International Settlements, was studying the "Policy issues raised by both bilateral and multilateral currency settlement arrangements" which were identified in the February 1989 "Report on netting schemes", prepared by the G-10 Group of Experts on Payment Systems of the central banks of the Group of Ten countries. While the studies on netting currently being carried out concentrated on foreign exchange markets in general, they would also be considering the netting of payment obligations. One of several working groups would address legal issues related to netting.

65. It was decided that the Secretariat should follow those studies and, at a later session, report to the Working Group on the conclusions that had been reached, including the submission of a draft text for possible inclusion in the Model Law if that seemed appropriate.

### C. Responsibility of originator's bank

66. The Working Group noted that at its eighteenth session it had agreed to consider at its next session the suggestion that article 5 should include a provision similar to article 7(1)(c), first sentence, and article 7(1)(d), spelling out that the originator's bank was responsible to the originator for the proper completion of the credit transfer (A/CN.9/318, para. 155). It was noted that the Working Group had already decided at the current session that article 5(3)(b), the money-back guarantee when a payment order consistent with the contents of the payment order issued by the originator was not accepted by the beneficiary's bank, should apply even though it was not possible for the originator's bank or a subsequent intermediary bank to recover funds it had paid to its receiving bank because of the insolvency of that receiving bank (see paragraph 58, above).

67. The Working Group considered generally the responsibility of the originator's bank to the originator both for reimbursement of the principal amount transferred under article 5(3)(b) and for damages under article 9. Under one view, the originator's bank and each subsequent receiving bank should be responsible only for its own actions. Under a second view, the originator's bank should be responsible to the originator both for the return of the principal amount and for damages if the credit transfer was not carried out properly. Through the recourse procedures anticipated in articles 5(3)(b) and 9(2), the ultimate loss

would be passed to the bank where the failure in the credit transfer occurred. Under a third view, the money-back guarantee should be retained for situations where the credit transfer was not completed, but that in situations where the transfer was completed, a bank should be responsible in damages only for its own improper execution.

68. In favour of a broad responsibility of the originator's bank to the originator, it was stated that the originator's bank was in a much better position than was the originator both to find out what had gone wrong and to recover the funds or damages, as the case might be, from its receiving bank, especially when the receiving bank was in a foreign country. It was stated to be a general principle of law that when a person contracted to undertake an activity and engaged third parties to fulfil that obligation, he remained responsible for the fulfilment of the contractual obligation by those third parties. This was said not to be a question of absolute liability, since article 10 provided for a number of cases in which the bank would have no liability and article 9(5)(d) provided for a limited liability in the one case in which damages were apt to be significant, i.e., loss of profit or similar losses that might arise as a result of an incomplete or improper completion of the credit transfer.

69. It was suggested that as a result of the right of recourse the ultimate financial burden to the originator's bank would not be very high. It was pointed out that the suggested rule for the Model Law was the current rule in a number of countries and that the banks in those countries were able to bear the responsibility without difficulty.

70. In favour of a responsibility limited to the bank's own actions, it was stated that it was also a general principle of law that a person who contracts to undertake an activity could limit his responsibility to the best choice of a competent subcontractor without guaranteeing proper execution by the subcontractor. That would mean that each bank contracted only that it would itself act properly. It was not in a position to control the actions of communications services and other banks. It was said that it would be particularly improper to hold the originator's bank responsible to the originator for the improper actions of a bank that had been designated by the originator.

71. In reply to the latter point it was stated that the draft Model Law already provided in article 5(5) that a bank was not always obligated to follow an instruction of its sender specifying an intermediary bank, funds transfer system or means to be used in carrying out the transfer.

72. In regard to the financial consequences of the proposed rule, it was stated to be a matter of pricing. An increase of responsibility for banks in those countries that did not currently have the suggested rule would probably increase their costs and the price they charged for making credit transfers.

73. It was stated that if the Model Law made the originator's bank responsible to the originator for the successful conclusion of the credit transfer, the Model Law should also provide the possibility for the originator's

bank and the originator to contract for a lower level of responsibility. It was also stated that that might lead to the regrettable loss of the desired uniformity of law.

74. After extensive discussion the Working Group reiterated its decision to retain the money-back guarantee in article 5(3)(b) (see paragraph 58, above). It decided to return to the question of the extent of the liability of the originator's bank for damages when it discussed article 9 (see paragraph 144, below).

#### D. Instructions to receiving banks, article 5(5)

75. The Working Group decided to adopt article 5(5) with the addition of "excessive costs" as a justifiable reason for a receiving bank not to follow the instructions given to it.

#### E. Time to accept and execute payment order or give notice, article 7

##### Paragraph (1)

76. It was noted that the definitions of "execution date", "pay date" and "value date" were set forth in article 2 while article 7 set forth the time within which the receiving bank was required to act in respect of those dates.

77. It was stated that the *chapeau* of paragraph (1) was incorrect in that it stated an obligation of the receiving bank to accept and execute a payment order rather than the time within which the receiving bank was required to act.

78. It was suggested that the execution date was significant only in the context of the obligation of the sender to pay the receiving bank under article 4(4); if the receiving bank accepted the payment order prior to the execution date either expressly or by executing the order, the sender was not obligated to pay the receiving bank the amount of the order until the execution date. In that respect premature execution created a credit risk for the receiving bank. In reply it was stated that the execution date might also have significance if one of the parties became insolvent prior to that date. Furthermore, the sender should not lose its power to revoke its payment order prior to the execution date. The Working Group was in agreement that the execution date was the date on which the receiving bank was obligated to execute the order.

79. The Working Group agreed with the definition of "value date" as contained in article 2(n). It was suggested, however, that the value date only provided information to the receiving bank as to when it could expect to receive funds from the sender. Under article 5(1) the receiving bank would have no obligation to accept the order or give notice of rejection until it had in fact received sufficient funds.

80. It was stated that in respect of a payment order that contained a pay date, the originator's bank and an intermediary bank should both be obligated to execute the order in sufficient time for the beneficiary's bank to accept it and to place the funds at the disposal of the beneficiary on that date.

*Paragraph (2)*

81. It was stated that paragraph (2) should not apply to an originator's bank that received a payment order too late for it to be sent to the beneficiary's bank in time for that bank to place the funds at the disposal of the beneficiary on the pay date. In such a case the originator's bank should be expected to inform the originator that the pay date could not be met.

82. It was suggested that the requirement that a bank might have to act on the date that it received a payment order might not be realistic in the case of a bank with numerous branches. It was stated that the problem was particularly difficult if some of the branches were in foreign countries, but that difficulties would also be faced with domestic branches. In this respect the Working Group recalled that it had decided at its eighteenth session that it would consider the status of branches in respect of the individual substantive rules of the Model Law (A/CN.9/318, para. 53). The Working Group decided that, for the purposes of the time within which a bank was required to act, branches of a bank, including domestic branches, should be considered to be separate banks.

*Paragraph (3)*

83. The Working Group agreed with paragraph (3).

*Paragraph (4)*

84. Under one view, the provision requiring a receiving bank that decided to reject a payment order prior to the execution or pay date to give notice of the rejection promptly should be retained since it would be of benefit to the sender. It was suggested, however, that the time when the notice of rejection had to be given should not be measured by the time when the decision had been made, since that raised difficult questions of proof.

85. Under another view, the paragraph served no real purpose. According to article 5(1), no notice of rejection had to be given unless the receiving bank had already received sufficient funds to pay for the order. It would be a rare occasion when that was significantly prior to any decision to reject a payment order.

86. After discussion, the Working Group decided to delete any requirement of early notice of rejection.

*Paragraph (5)*

87. The Working Group agreed with paragraph (5).

*New proposal*

88. A working party consisting of the representatives of Japan and the United States of America and the observer from the International Chamber of Commerce was requested to prepare a new draft of article 7 in the light of the discussion. The proposal of the working party was as follows:

*"Article 7*

"(1) A receiving bank that must give the required notice or execute the order as provided in article 5 must comply with the earliest to occur of the following:

"(a) A receiving bank is obligated to execute an order after it has received sufficient funds and (i) on the execution date as stated in the payment order if such a date is stated, or (ii) when neither an execution date nor a pay date is stated on the payment order, on the date the order is received unless the nature of the order indicates that a different execution date is appropriate.

"(b) When a pay date is stated on the payment order accepted by the originator's bank or an intermediary bank, the obligation of the bank is to execute the order in sufficient time for the beneficiary's bank to act upon the payment order by that date. A beneficiary's bank that accepts a payment order on or before the pay date is obligated to place the funds at the disposal of the beneficiary on that date.

"(2) Notwithstanding paragraph (1), when no pay date is stated on a payment order accepted by the originator's bank, the obligation of the bank is that the payment order be issued to the beneficiary's bank within an appropriate period of time for that type of order.

"(3) A receiving bank that receives a payment order or sufficient funds too late to execute the order in conformity with its terms complies with the provisions of paragraphs (1) and (2) if it either executes the order or gives the notice of rejection provided for under article 5 on the day that it receives both the payment order and sufficient funds.

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

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

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

"The second sentence of article 2(l) should be deleted."

89. It was stated that the rule in respect of the cut-off time, now appearing in paragraph (4) of the new proposal, was too short since an order might arrive minutes prior to the cut-off time. It was unreasonable to expect the bank to execute the order that day. In reply it was stated that the bank would fix its cut-off time early enough so that it could execute orders received by the cut-off on the day they were received. It was noted that, depending on the bank and the type of order, a bank's cut-off time for orders to be executed that day might be as early as noon.

90. The deletion of paragraph (4) in the original text, to the effect that a receiving bank that makes a decision to reject a payment order prior to the execution date must give notice of the rejection on the day the decision was made, was said to lead to the incorrect result since the sender should have the maximum opportunity to correct its payment order. Other questions were raised as to whether the proposed rules in respect of the execution date and pay date worked in an appropriate manner. In particular, it was suggested that paragraph (1) should include a reference to the need for the receiving bank to have received sufficient funds before it had any obligation to execute a payment order or to give notice of rejection. In reply it was said that the requirement that there be sufficient funds related to the basic obligation to execute or give notice and not to the time requirements discussed in article 7.

91. Since the discussion on the new proposal took place at the end of the session, it was decided that the delegations of Japan and the United States should take those comments into account and make the necessary adjustments. It was also noted that the restructuring of the text that was being undertaken by the drafting group (see para. 145) might affect the structure of paragraphs (1) and (2). The Working Group decided that, since it would not have the opportunity to consider the text as it would be re-drafted in the light of the discussion on the new proposal and of the restructuring of the text, it would return to the matter at a future session.

#### **F. Revocation and amendment of payment order, article 8**

##### *Paragraphs (1) to (3)*

92. Under one view, the right of the originator to revoke his payment order should terminate at an early point of time. That point of time might be as early as when the originator sent his payment order to the originator's bank or it might be when the originator's bank acted on the payment order by debiting the originator's account or by sending its own order to its receiving bank. Under that view, paragraph (2) would be unnecessary.

93. In support of that view, it was stated that modern electronic systems did not allow sufficient time to revoke payment orders as envisioned in paragraphs (1) and (3), much less to attempt to follow a payment order through the chain of banks and to catch it as envisioned in para-

graph (2). Furthermore, if they were to evolve into true payment systems, they ought not to provide for revocation in any circumstances.

94. Under another view, the originator should have a right to revoke his payment order until the latest possible time, which would be when the beneficiary's bank accepted the order sent to it. If the revocation did not arrive in time because of the use of high-speed electronic systems, it would not be effective. However, that was not sufficient reason to preclude the originator from having the opportunity to attempt to revoke his order. Since the Working Group had decided at its seventeenth session that any revocation by the originator of the credit transfer after his payment order had been executed by the originator's bank should be permitted only by sending the revocation through the same chain of banks as the payment order, paragraph (2) was a necessary provision (A/CN.9/317, para. 125).

95. It was noted that both paragraphs (1) and (3) provided that a revocation was effective only if it had been received "in sufficient time" for the receiving bank to act on it before the receiving bank had executed the order. It was stated that it was unclear what was meant by sufficient time, especially since what was sufficient time might be different in respect of large value transfer systems and of batch systems. In particular, it was not clear whether only ordinary speed was anticipated or whether the receiving bank was expected to use extraordinary means to implement the revocation.

96. It was questioned whether a revocation of a payment order would have to be made through the same channels as the payment order itself. It was said that the question was of particular importance when the payment order had been sent by a highly secure channel of communications and the revocation was sent through a less secure channel of communications. In this regard it was noted that at the seventeenth session it had been suggested that the Model Law should make it clear that messages revoking payment orders were subject to the same rules as to authentication and liability for failure to follow the instruction as were payment orders themselves (A/CN.9/317, para. 125).

97. There was general agreement that paragraph (2) was inadequately drafted. It was stated that paragraph (2) did not make it clear that the receiving bank must revoke its own order on receipt of such an instruction from its sender, nor did it make clear within what period of time the receiving bank had to act or the consequences of its failure to act. It was pointed out that the current text stated that the sender might require "a" receiving bank to revoke or amend its payment order whereas the sender should be able to require only "its" receiving bank to do so.

98. It was suggested that the Model Law should provide that the senders and receiving banks might agree with their senders to other rules that made payment orders issued by the sender irrevocable or effective only if received at an earlier point of time than that provided in the Model Law itself.

99. At the conclusion of the discussion the representative of the United Kingdom and the observer from Finland were asked to prepare a new draft which would reflect the discussion and which would retain the current three paragraphs, provide that a payment order could be revoked until its expressed execution or pay date even if it had been executed prematurely and provide that a revocation was subject to the same rules on authentication as were payment orders.

100. The Working Group noted that the discussion had focused on the revocation of payment orders and that the amendment of orders might raise additional policy issues.

#### *Paragraphs (4) and (5)*

101. The Working Group deferred discussion on the paragraphs until it had an opportunity to consider the new draft prepared by Finland and the United Kingdom, which it understood might contain a new text of the paragraphs.

#### *Paragraph (6)*

102. It was stated that the meaning of the word "incapacity" was unclear and should be clarified at some point in the future. It was noted that the paragraph was not intended to cover cases of duress. It was suggested that the paragraph should make it clear that it applied only to the situation in which the death or incapacity occurred after the issue of the payment order. It was also suggested that the case of bankruptcy should also be covered by the provision.

103. The Working Group decided that the paragraph should be retained with the addition of the word "bankruptcy".

#### *Paragraph (7)*

104. Under one view, the Model Law should contain a provision whereby the beneficiary's bank could reverse credits to the beneficiary's account in case of clear error or fraud. It was stated that banks did so regularly and it would be advantageous if their actions were clearly authorized and regulated. It was suggested that the provision might also cover cases in which there had been an effective revocation of a payment order that the receiving bank had failed to act upon.

105. Under another view, the paragraph should be deleted. It was stated that the provision did not deal with the credit transfer itself, but rather with the relations between the beneficiary and the beneficiary's bank subsequent to the credit transfer. It was noted that in any State that adopted the Model Law there would be a different rule for the reversal of credits arising out of domestic credit transfers, which would not be subject to the Model Law. It was also stated that it was necessary that a provision that authorized the reversal of credit to an account should be in accord with the general principles of law in those States in which the Model Law would be adopted, a task that was said to be difficult since the subject was complicated.

106. After discussion the Working Group decided to delete the paragraph.

#### *Paragraph (8)*

107. It was noted that the question of the extent to which courts should order banks not to release funds because of fraud or error in the transaction was expected to be considered in the Working Group on International Contract Practices in the context of its preparation of a model law on guarantees and stand-by letters of credit. It was said that the issue was important and complicated.

108. It was suggested that the paragraph should be deleted. The provision added nothing to what would be the situation in any case. A bank would always be required to obey the order of a court so long as the order was in force. It was said that it would be difficult to prepare a provision that added anything new and that could be adopted.

109. The Working Group decided to delete the paragraph but to consider a proposal that was to be presented authorizing courts to restrain a bank from acting on a payment order if proper cause was shown.

#### *Branches*

110. The Working Group decided that branches of banks, even if in the same country, should be considered to be separate banks for the purposes of the article.

#### *New proposals*

111. The working party consisting of the observer from Finland and the representative of the United Kingdom proposed a new text of the article. In addition, the delegations of France and Italy and of the United States proposed new texts of the article while the observer from the Banking Federation of the European Communities proposed a new paragraph to be added to the article. Because of a shortage of time, the Working Group considered only the text proposed by the working party.

112. The proposal of the working party was to replace paragraphs (1) to (5) of the current text by the following:

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

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

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

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

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

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

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



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

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

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

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

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

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

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

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

113. The Working Group decided to adopt the proposal. Since the proposal was considered at the end of the session, comments were made on it for the purpose of its refinement at the next session. The other delegations that had submitted proposals in respect of article 8 were invited to present their proposals again at the next session of the Working Group if they believed it opportune.

114. It was suggested that the rule in the new paragraph (1)(c) that the revocation had to be “authenticated in the same manner as the payment order” might not be correct. The case was posed of a paper-based payment order that was revoked by a tested telex. In reply it was noted that the provision was in response to an earlier decision of the Working Group (see para. 96, above). An attempt had been made to draft a requirement that the authentication had to be as good or better than the authentication of the payment order being revoked, but it had not proven possible to do so.

115. Concern was expressed over the effect of the new paragraph (3) since the originator might not know that there were agreements between particular banks through which the credit transfer might pass that made a payment order between those banks irrevocable. Another suggestion was that the amount of the funds to be returned in paragraph (6) should be the original amount of the transfer less costs. It was pointed out that this was a question that arose in respect of the reimbursement of the funds in case of an unsuccessful credit transfer as well and that it would need to be addressed at a later stage.

116. It was stated that the words “as promptly as possible under the circumstances” in paragraph (4) provided a vague test that would be difficult to apply in particular fact situations. As a result, an increase in disputes could be anticipated between the originator and the receiving bank as to whether the bank had acted to revoke its payment order in the requisite time. It was also stated that the proposed time requirement appeared to be more stringent than was the requirement imposed by the Model Law on the receiving bank as to when it had to execute the order by sending its own payment order to the next bank in the transfer chain. This was said to be inappropriate since the function of the banks was to execute payment orders promptly and efficiently while the revocation of orders constituted an interference with that function. It was proposed that the qualification “reasonable” be used in place of the current formulation.

## G. Liability and damages, article 9

### Paragraph (1)

117. It was noted that paragraph (1) dealt only with the question as to the parties to whom a receiving bank that had failed in its obligations would be liable. The question as to whether the originator's bank should be liable to the originator for the successful completion of the credit transfer was dealt with in paragraph (2). The question as to the types of loss for which the bank could be held liable was dealt with in paragraph (5).

118. Under one view a receiving bank should be liable only to the party with which it had a contractual relationship, which was said to be the sender.

119. Under another view the use of various theories of contract law, such as assignment of claims, would make it possible for a prior party in the credit transfer chain to have a contractual claim against the receiving bank. Therefore, it was suggested that it was preferable to determine as a matter of policy which parties should have a claim against the bank whose failure had led to loss and to give those parties the right to claim for the loss as a statutory right. That might be done by analysing the various types of failure that could occur and by determining the party who had suffered economic loss as a result.

120. It was noted that the Working Group had already decided that in the case of a failed credit transfer, the originator should have the right to recover the principal

amount of the transfer from the originator's bank, and that each sending bank in turn had the right to recover any funds it had paid to its receiving bank (see paragraph 58, above). It was also noted that the originator's right was based on a money-back guarantee from the originator's bank to the originator and not as a matter of liability of the originator's bank for the failed credit transfer.

121. It was stated that, since paragraph (5)(d) of the current text restricted significantly the right to claim for lost profits or similar damages, the major form of loss to be considered would be the loss of interest arising out of the late completion of a credit transfer.

122. The case was posed of the transfer in which the originator's account was debited on the appropriate day but, because of a delay at an intermediary bank, the beneficiary's account was credited later than it would have been if the transfer had been carried out in the appropriate period of time. In such a case the bank that caused the delay would have had the use of the funds during the period of the delay, thereby benefiting from the fact of the delay. The Working Group agreed that that result would be improper and that the interest for the period of the delay should not be retained by the bank. The Working Group then considered which party should have a right to claim for the interest from the bank.

123. Under one view it was necessary to look to the underlying contractual relationship between the originator and the beneficiary to determine whether the originator or the beneficiary would have a right to recover the lost interest from the bank. It was stated that the beneficiary should recover the interest from the originator and the originator should in turn recover the interest from the bank.

124. Under another view the determination of the proper party to recover interest for late completion of a credit transfer should be analysed only in terms of the credit transfer, which was said to be independent from any underlying transaction that might have given rise to the transfer.

125. It was stated that it was the beneficiary, and not the originator, who suffered the economic loss in such a case, at least in the first instance. The loss to the beneficiary was evident where the beneficiary had a contractual right against the originator to receive the funds on a particular day, thereby having a legitimate expectation that it would be in a position to invest or otherwise use the funds as of that day. It was said that the loss to the beneficiary was equally evident when the beneficiary had an expectation of receiving the funds on a particular day, even though it did not have a contractual right to receive them that day. The least evident case was when the beneficiary had no expectation as to the day when the funds would be received. It was stated, however, that even in such a case the beneficiary would have had the use of the funds if they had arrived when they should. Once it was agreed that the bank should not be allowed to keep the interest it had earned by reason of the delay, the only party who could have a claim to that interest would be the beneficiary.

126. It was noted that it was current banking practice in many important banking centres for a bank at which a transfer was delayed to add the appropriate amount of interest to the amount being transferred. As a result the beneficiary would automatically receive it. This was said to be highly efficient and expeditious, not requiring any inquiry into the facts of the underlying transaction, and a practice that the legal system should recognize. Moreover, in a large number of cases, the interest received by the beneficiary would be approximately equal to the loss it would have suffered as a result of the delay.

127. In reply it was stated that, while the practice was commendable, it was not necessary to provide for it specifically in the Model Law.

128. Concern was expressed as to how granting the beneficiary a legal right to recover the interest arising out of the late completion of a credit transfer would affect the right of the beneficiary against the originator. It was noted that in many cases of delayed payment of an obligation the interest rate on the amount of the delayed payment would be considerably more than the interest rate at which the beneficiary would have been compensated by the bank that caused the delay.

129. It was suggested that the receipt of interest from the bank would serve to reduce the beneficiary's claim against the originator. It was also stated that this left open the question as to whether the beneficiary would continue to have a claim against the originator for the balance of the interest due on the underlying obligation under the law governing the obligation and, if it did, whether the originator would have a claim against the bank for that amount.

130. Concern was also expressed as to what rights the beneficiary would have if the interest for delay was not forwarded to it by the bank. Since the proposal to give the beneficiary a right to recover interest for the delay in completion of the transfer seemed to require that the originator would also have such a right in appropriate cases, it was questioned as to whether it would be necessary to establish the relative priority of the two claims. It was also observed that it might be difficult to establish the rate at which interest would accrue.

131. The Working Group decided that, in the light of the discussion, it would retain the principle of paragraph (1), but would place it in square brackets for the time being. It also decided that it would be useful to consider providing in the Model Law that the beneficiary would have a direct right to recover interest resulting from the delay against the bank that caused the delay. Since the proposal raised a number of questions that would require consultation, the Working Group requested the Secretariat to prepare a draft of a provision for its consideration at its next session.

132. It was suggested that the Secretariat should also be requested to consider including in the provision the right of the beneficiary to recover for loss caused by a change in exchange rates during the delay. That request led to a discussion of exchange losses, at the end of which the request to the Secretariat was adopted.

*Paragraph (5)(b)*

133. Under one view exchange losses arising out of the delayed completion of a credit transfer should not be recoverable. It was stated that such losses were rare. Where the originator's account was to be debited in a currency other than the currency of the transfer, the originator's bank would normally make the conversion so that its payment order would be denominated in the currency of the transfer. Therefore, the only occasions when there could be an exchange loss arising out of delay was when the originator's bank was not in a position to make the conversion itself. That situation arose only when the originator's bank was a small bank that did not often engage in international transfers or when the currency of the transfer was a currency that was not frequently used for international transfers.

134. It was also said that, while the fact that such losses might occur in case of delay was foreseeable, neither the fact that such losses would occur nor the potential amount of loss was foreseeable. In this regard a distinction was drawn between interest losses, which were an automatic consequence of delay and for which the bank should be liable, and exchange losses, which were not an automatic consequence of delay. It was said that during the period of any delay the exchange rate might not change or might change to the benefit of the originator as well as to his detriment. It was suggested that the loss should be compared to the situation where there was an increase in the price of goods that were to be purchased with the funds transferred. Paragraph (5)(b) might be deleted and exchange losses could be recovered under the provisions of paragraph (5)(d).

135. Under another view exchange losses should be recoverable. It was said that if they were rare, that should decrease the concern over making them recoverable. When the loss did occur as a result of the delay in the transfer, there was no reason why the originator or the beneficiary should bear it. The situation was said not to be the same as when the price of goods rose during the delay since the beneficiary would have received less funds in the currency of the transfer than he should have received. That fact in particular made it easy to calculate the amount of the loss.

136. After discussion the Working Group decided to retain paragraph (5)(b).

*Paragraph (5)(c)*

137. It was stated that there was no particular value in retaining the first portion of paragraph (5)(c) relating to the costs of a new payment order. Those costs were very small and in the usual situation they would be required to be borne by the banks in any case as a result of their obligation under article 5(3)(c) to assist the originator to complete the transfer.

138. In regard to the costs of legal representation, it was stated that in many countries there were provisions in the procedural law that allocated those costs to the parties. It was recognized that in some other countries each party to a dispute had to bear his own legal costs and that a pro-

vision of the nature of paragraph (5)(c) could be of value in those countries. Moreover, even in those countries in which the law of procedure allocated costs of legal representation, it did not always allocate the costs that arose prior to litigation.

139. The Working Group decided to put the second part of paragraph (5)(c) in square brackets. Another suggestion was to place in a footnote words such as "even if not recoverable under the law of civil procedure" so as to reflect the concerns expressed above.

*Paragraph (5)(d)*

140. In respect of paragraph (5)(d) a proposal was made to delete the paragraph. In support of the proposal it was said that users as well as banks wished the credit transfer system, and especially that used for high value transfers, to be fast, inexpensive and efficient. It was important that the system operate automatically with a minimum of attention to individual payment orders. Liability for losses of the type covered by paragraph (5)(d) would require determination of the facts in respect of the underlying transactions, a procedure that would be time consuming and costly. It was said that the losses should be recoverable, if at all, only to the extent that at the time of making the transfer the loss was foreseeable to the bank in respect of the fact that loss might occur, the nature of the loss and its amount. That raised difficult questions as to who in the bank would be expected to know of those elements. It was also said that the subparagraph would put the banks in the position of offering two different services, a credit transfer service and an insurance service. It was said that if originators wished to contract for such insurance, it would be preferable for them to do so directly with an insurance company that could better evaluate the risk of loss.

141. In opposition to the proposal to delete the subparagraph it was said that banks were in essentially the same position as any other entity that offered a service to the public. The same arguments were being made as to the efficiency of the service and the proper allocation of losses caused by their failures. It was said that it did not appear that credit transfers were so dangerous for the banks or that it would place such an undue burden upon them to hold them responsible for the losses envisaged under the restricted conditions set out in paragraph (5)(d).

142. The formulation of paragraph (5)(d) was criticized as being imprecise. It was said that it did not make it clear as to what types of losses were to be covered or that those losses should have been the direct consequence of the failure on the part of the bank. Various objections were presented to the formula taken from article 8 of the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules). It was said that while the formula indicated the general nature of the limitation that was to be placed on the right of recovery, it had been drafted with the problems of maritime transportation in mind and not those of making credit transfers.

143. After discussion it was decided that the subparagraph should be retained but that square brackets should

be placed around both the words "any other loss" and around the words taken from the Hamburg Rules.

*Paragraph (2)*

144. Although the Working Group was able to engage in only a short discussion of paragraph (2) for lack of time, it recognized that the basic question as to whether the originator's bank should be responsible to the originator for the successful completion of the credit transfer had underlain much of the debate on other aspects of the draft Model Law throughout the session and had been the subject of an extensive discussion earlier in the session (see paragraphs 66 to 74, above). At the conclusion of the discussion it was decided that the paragraph would remain in the draft Model Law at this time but that it was a subject to which the Working Group would have to return.

## H. Drafting group

145. A drafting group consisting of the representative of the United States and the observers from Finland and Switzerland was requested to restructure the draft Model Law and to prepare a new text for discussion at the next session of the Working Group. The new text, which is intended to reflect the decisions of the Working Group at the present session, is contained in annex I to this report.

## II. FUTURE SESSIONS

146. The Working Group noted that the twentieth session would be held at Vienna from 27 November to 8 December 1989 and that the twenty-first session would be held in New York from 9 to 20 July 1990.

## ANNEX I

### Draft Model Law on International Credit Transfers resulting from the nineteenth session of the Working Group on International Payments\*

#### CHAPTER I. GENERAL PROVISIONS

##### Article 1. *Sphere of application\**

- (1) This law applies to credit transfers where the originator's bank and the beneficiary's bank are in different countries.
- (2) For the purpose of determining the sphere of application of this Law, branches of banks in different countries are considered to be separate banks.

##### Article 2. *Definitions*

- (a) "Credit transfer" means a complete movement of funds from the originator to the beneficiary pursuant to a payment order received by the originator's bank [directly] from the originator. A credit transfer may involve one or more payment orders.
- (b) "Originator" means the issuer of the first payment order in a credit transfer.
- (c) "Beneficiary" means the ultimate person intended to receive the funds as a result of a credit transfer.
- (d) "Sender" means the person who sends a payment order including the originator and any sending bank.
- (e) "Bank" means a financial institution which, as an ordinary part of its business, engages in credit transfers for other persons.
- (f) A "receiving bank" is a bank that receives a payment order.
- (g) "Intermediary bank" means any bank executing a payment order other than the originator's bank and the beneficiary's bank.
- (h) "Funds" or "money" includes credit in an account kept by a bank and includes credit denominated in a monetary unit of

account that is established by an intergovernmental institution or by agreement of two or more States, provided that this Law shall apply without prejudice to the rules of the intergovernmental institution or the stipulations of the agreement.

- (i) "Payment order" means a message, whether written or oral, that contains an order to the receiving bank to pay, or to cause another bank to pay, to a designated person a fixed or determinable amount of money.
- (j) "Authentication" means a procedure to determine whether all or part of a payment order is authorized, and which is the product of an agreement.
- (k) "Cover" means the provision of funds to a bank to reimburse it for a payment order sent to it. The provision of cover might precede or follow execution of the order by the receiving bank.
- (l) "Execution date" means the date when the receiving bank is to execute the payment order, as specified by the sender. When no execution date is stated on a payment order, the execution date of that order shall be deemed to be the date the order is received, unless the nature of the order indicates that a different execution date is appropriate.
- (m) "Pay date" means the date when funds are to be at the disposal of the beneficiary, as specified by the originator.
- (n) "Value date" means the date when funds are to be at the disposal of the receiving bank.

##### Article 3. *Contents of payment order*

A payment order is required to contain, either explicitly or implicitly, at least the following data:

- (i) identification of the sender,
- (ii) identification of the receiving bank,
- (iii) the amount of the transfer, including the currency or the unit of account,
- (iv) identification of the beneficiary,
- (v) identification of the beneficiary's bank

\*The draft Model Law was restructured by a drafting group during the nineteenth session and a new text was prepared for discussion at the twentieth session of the Working Group. The new text, presented in this annex, is intended to reflect the decisions of the Working Group made at the nineteenth session.

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

## CHAPTER II. DUTIES OF THE PARTIES

Article 4. *Obligations of sender*(1) *Variant A*

A purported sender is bound by a payment order, if he authorized it or if it was issued by a person who, pursuant to the applicable law [of agency], otherwise had the power to bind the purported sender by issuing the payment order.

*Variant B*

A purported sender is bound by a payment order if it was issued by the purported sender or by another person who had the authority to bind the purported sender.

(2) Notwithstanding anything to the contrary in paragraph (1), when a payment order is subject to authentication, a purported sender of such an order is bound if:

- (a) the authentication provided is a commercially reasonable method of security against unauthorized payment orders,
- (b) the amount of the order is covered by a withdrawable credit balance or authorized overdraft in an appropriate account of the sender with the receiving bank or there is an agreement between the sender and the receiving bank that such payment orders are to be executed despite the absence of such balances or overdrafts, and
- (c) the receiving bank complied with the authentication.

(3) *Variant A*

A purported sender [that is not a bank] is, however, not bound by a payment order under paragraph (2) if

- (a) the actual sender was a person other than a present or former employee of the purported sender, and
- (b) the actual sender had gained access to the authentication procedure without fault on the part of the purported sender.

*Variant B*

No sender may become bound under paragraph (2) if the sender proves that the payment order was executed by

- (a) a present or former employee or agent of the receiving bank, or
- (b) a person acting in concert with a person described in (a), or
- (c) any other person who, without the sender's authorization, obtained confidential information about the authentication from a source controlled by the receiving bank, regardless of fault.

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

Article 5. *Acceptance or rejection of a payment order by receiving bank other than a beneficiary's bank*

(1) If a receiving bank decides not to accept a sender's payment order, it is required to notify the sender of the rejection, unless one of the reasons is insufficient funds. A notice of

rejection of a payment order must be given not later than on the execution date.

(2) A receiving bank that is not the beneficiary's bank accepts the sender's payment order at the earliest of the following times:

- (a) when the time within which a required notice of rejection should have been given has elapsed without notice having been given,
- (b) when the bank receives the payment order, provided that the sender and the bank have agreed that the bank will execute payment orders from the sender without notification that cover is in place,
- (c) when it notifies the sender of acceptance, or
- (d) when it sends a payment order intended to carry out the payment order received.

Article 6. *Obligations of receiving bank other than beneficiary's bank*

(1) The provisions of this article apply to a receiving bank other than the beneficiary's bank.

(2) When a payment order is received that contains information which indicates that it has been misdirected and which contains sufficient information to identify and trace the sender, the receiving bank shall notify the sender of the misdirection.

(3) If there is an inconsistency in a payment order between the words and figures that describe the amount of money, the receiving bank is required to notify the sender of the discrepancy unless the sender and the bank had agreed that the bank would rely upon either the words or the figures, as the case may be.

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

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

Article 7. *Acceptance or rejection by beneficiary's bank*

(1) If the beneficiary's bank decides not to accept a sender's payment order, it is required to notify the sender of the rejection, unless one of the reasons is insufficient funds. A notice of rejection of a payment order must be given not later than on the execution date.

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

- (a) when the time within which a required notice of rejection should have been given has elapsed without notice having been given,

- (b) when the bank receives the payment order, provided that the sender and the bank have agreed that the bank will execute payment orders received from the sender without notification that cover is in place,
- (c) when it notifies the sender of acceptance,
- (d) when the bank credits the beneficiary's account or otherwise pays the beneficiary,
- (e) when the bank gives notice to the beneficiary that it has the right to withdraw the credit or the funds,
- (f) when the bank otherwise applies the credit as instructed in the payment order,
- (g) when the bank applies the credit to a debt of the beneficiary owed to it or applies it in conformity with an order of a court.

#### Article 8. *Obligations of beneficiary's bank*

(1) When a payment order is received that contains information which indicates that it has been misdirected and which contains sufficient information to identify and trace the sender, the beneficiary's bank shall notify the sender of the misdirection.

(2) If there is an inconsistency in a payment order between the words and figures that describe the amount of money, the beneficiary's bank is required to notify the sender of the discrepancy unless the sender and the bank had agreed that the bank would rely upon either the words or the figures, as the case may be.

(3) Where the beneficiary is described by both words and figures, and the intended beneficiary is not identifiable with reasonable certainty, the beneficiary's bank must notify, within the time prescribed in article 9, paragraph (4), its sender, and also the originator's bank if it is identified on the payment order.

#### (4) *Variant A*

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

#### *Variant B*

A beneficiary's bank that accepts a payment order fulfils its obligations under that payment order

- (a) if the beneficiary maintains an account at the beneficiary's bank into which funds are normally credited, by, in the manner and within the time prescribed by law, including article 9, or by agreement between the beneficiary and the bank
  - (i) crediting the account,
  - (ii) placing the funds at the disposal of the beneficiary and
  - (iii) notifying the beneficiary; or
- (b) if the beneficiary does not maintain an account at the beneficiary's bank, by
  - (i) making payment by the means specified in the order or by any commercially reasonable means, or
  - (ii) giving notice to the beneficiary that the bank is holding the funds for the benefit of the beneficiary.

#### Article 9. *Time for receiving bank to execute payment order*

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

- (a) a later execution date is specified in the order, in which case the order shall be executed on that date,
- (b) the order contains a specification of a pay date and that date indicates that later execution is appropriate in order for the beneficiary's bank to accept a payment order and place the funds at the disposal of the beneficiary by the pay date.

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

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

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

#### Article 10. *Revocation*

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

- (a) it was issued by the sender of the payment order,
- (b) it was received in sufficient time before the execution of the payment order to enable the receiving bank, if it acts as promptly as possible under the circumstances, to cancel the execution of the payment order, and
- (c) it was authenticated in the same manner as the payment order.

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

- (a) it was issued by the sender of the payment order,
- (b) it was received in sufficient time before acceptance of the payment order to enable the beneficiary's bank, if it acts as promptly as possible under the circumstances, to refrain from accepting the payment order, and
- (c) it was authenticated in the same manner as the payment order.

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

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

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

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

- (b) if, in spite of the revocation, the credit transfer has been completed due to a failure of the receiving bank or a subsequent receiving bank to comply with its obligations under paragraphs (1), (2) or (4).
- (6) If a sender who, under paragraph (5), is not obligated to pay the receiving bank has already paid the receiving bank for the revoked payment order, the sender is entitled to recover the funds paid.
- (7) If the originator is not obligated to pay for the payment order under paragraph (5)(b) or has received a refund under paragraphs (5)(b) or (6), any right of the originator to recover funds from the beneficiary is assigned to the bank that failed to comply with its obligations under paragraphs (1), (2) or (4).
- (8) The death, bankruptcy, or incapacity of either the sender or the originator does not affect the continuing legal validity of a payment order that was issued before that event.
- (9) A branch of a bank, even if located in the same country, is a separate bank for the purposes of this article.

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

#### Article 11. *Assistance and refund*

A receiving bank other than the beneficiary's bank that accepts a payment order is obligated under that order:

- (a) where a payment order is issued to a beneficiary's bank in an amount less than the amount in the payment order issued by the originator to the originator's bank—to assist the originator and each subsequent sending bank, and to seek the assistance of its receiving bank, to obtain the issuance of a payment order to the beneficiary's bank for the difference between the amount paid to the beneficiary's bank and the amount stated in the payment order issued by the originator to the originator's bank.
- (b) where a payment order consistent with the contents of the payment order issued by the originator and containing instructions necessary to implement the credit transfer in an appropriate manner is not issued to or accepted by the beneficiary's bank—to refund to its sender any funds received from its sender, and the receiving bank is entitled to the return of any funds it has paid to its receiving bank.

#### Article 12. *Liability and damages*

[(1) A receiving bank that fails in its obligations under article 5 is liable therefor to its sender and to the originator.]

(2) The originator's bank and each intermediary bank that accepts a payment order is liable to its sender and to the originator for the losses as set out in paragraph (5) of this article caused by the non-execution or the improper execution of the credit transfer as instructed in the originator's payment order. The credit transfer is properly executed if a payment order consistent with the payment order issued by the originator is accepted by the beneficiary's bank within the time required by article 9.

(3) An intermediary bank is not liable under paragraph (2) if the payment order received by the beneficiary's bank was consistent with the payment order received by the intermediary bank and it executed the payment order received by it within the time required by article 9.

#### (4) The beneficiary's bank is liable

- (a) to the beneficiary for its improper execution or its failure to execute a payment order it has accepted to the extent provided by the law governing the [account relationship] [relationship between the beneficiary and the bank], and
- (b) to its sender and to the originator for any losses caused by the bank's failure to place the funds at the disposal of the beneficiary in accordance with the terms of a pay date or execution date stated in the order, as provided in article 9.
- (5) If a bank is liable under this article to the originator or to its sender, it is obliged to compensate for
- (a) loss of interest,
- (b) loss caused by a change in exchange rates,
- (c) expenses incurred for a new payment order [and for reasonable costs of legal representation],\*
- (d) [any other loss] that may have occurred as a result, if the improper [or late] execution or failure to execute [resulted from an act or omission of the bank done with the intent to cause such improper [or late] execution or failure to execute, or recklessly and with knowledge that such improper [or late] execution or failure to execute would probably result].

(6) If a receiving bank fails to notify the sender of a misdirected payment order as provided in articles 6(2) or 8(1), and the credit transfer is delayed, the receiving bank shall be liable:

- (a) if there are funds available, for interest on the funds that are available for the time they are available to the receiving bank, or
- (b) if there are no funds available, for interest on the amount of the payment order for an appropriate period of time, not to exceed 30 days.

(7) Banks may vary the provisions of this article by agreement to the extent that it increases or reduces the liability of the receiving bank to another bank and to the extent that the act or omission would not be described by paragraph (5)(d). A bank may agree to increase its liability to an originator that is not a bank but may not reduce its liability to such an originator.

(8) The remedies provided in this article do not depend upon the existence of a pre-existing relationship between the parties, whether contractual or otherwise. These remedies shall be exclusive and no other remedy arising out of other doctrines of law shall be available.

#### Article 13. *Exemptions*

A receiving bank and any bank to which the receiving bank is directly or indirectly liable under article 12 is exempt from liability for a failure to perform any of its obligations if the bank proves that the failure was due to the order of a court or to interruption of communication facilities or equipment failure, suspension of payments by another bank, war, emergency conditions or other circumstances that the bank could not reasonably be expected to have taken into account at the time of the credit transfer or if the bank proves that it could not reasonably have avoided the event or overcome it or its consequences.

\*Consideration may be given to allowing recovery of reasonable costs of legal representation even if they are not recoverable under the law of civil procedure.

## CHAPTER IV. CIVIL CONSEQUENCES OF CREDIT TRANSFER

Article 14. *Payment and discharge of monetary obligations; obligation of bank to account holder*

- (1) Unless otherwise agreed by the parties, payment of a monetary obligation may be made by a credit transfer to an account of the beneficiary in a bank.
- (2) The obligation of the debtor is discharged and the beneficiary's bank is indebted to the beneficiary to the extent of the payment order received by the beneficiary's bank when the payment order is accepted by the beneficiary's bank.
- (3) If one or more intermediary banks have deducted charges from the amount of the credit transfer, the obligation is discharged by the amount of those charges in addition to the amount of the payment order as received by the beneficiary's bank. Unless otherwise agreed, the debtor is bound to compensate the creditor for the amount of those charges.
- (4) To the extent that a receiving bank has a right of reimbursement from a sender by debit to an account held by the

receiving bank for the sender, the account shall be deemed to be debited when the receiving bank accepts the payment order.

## CHAPTER V. CONFLICT OF LAWS

Article 15. *Conflict of laws*

- (1) Persons who anticipate that they will send and receive payment orders may agree that the law of the State of the sender, of the receiver or of the State in whose currency the payment orders are denominated will govern their mutual rights and obligations arising out of the payment orders. In the absence of agreement, the law of the State of the receiving bank will govern the rights and obligations arising out of the payment order.
- (2) In the absence of agreement to the contrary, the law of the State where an obligation is to be discharged governs the mutual rights and obligations of an originator and beneficiary of a credit transfer. If between the parties an obligation could be discharged by credit transfer to an account in any of one or more States or if the transfer was not for the purpose of discharging an obligation, the law of the State where the beneficiary's bank is located governs the mutual rights and obligations of the originator and the beneficiary.

## ANNEX II

## Table of Concordance

*Draft Model Law on International Credit Transfers with sources of modifications*

<i>A/CN.9/328, annex I</i>	<i>A/CN.9/318, annex</i>	<i>Source of modifications (paragraph numbers refer to this report. WP.41 refers to A/CN.9/WG.IV/WP.41)</i>
1	1	
2(a)-(g)	2(a)-(g)	
2(h)	2(h)	WP.41, art. 2, comment 16
2(i)	2(i)	WP.41, art. 2, comment 18
2(j)-(n)	2(j)-(n)	
3	2(i)	WP.41, art. 2, comment 18
4	4	
5(1)	5(1), 7(1), (4)	Reworded by Drafting Group
5(2) <i>chapeau</i>	6(1)	
5(2)(a)	6(1)(b)	Reworded by Drafting Group
5(2)(b)	6(2)(a)	Para. 32
5(2)(c)		Para. 31
5(2)(d)	6(1)(a)	
6(1)		Drafting Group
6(2)	5(1 <i>bis</i> )	Para. 20
6(3)	3(1)	
6(4)	5(3)(a)	
6(5)	5(5)	Para. 75
7(1)	5(1), 7(1), (4)	Reworded by Drafting Group
7(2) <i>chapeau</i>	6(2)	
7(2)(a)		Para. 44
7(2)(b)		Para. 49
7(2)(c)	6(2)(a)	Para. 44
7(2)(d)		Para. 60
7(2)(e)-(g)	6(2)(c) Variant A	
8(1)	6(2)(c) Variant B-(e)	
	5(1 <i>bis</i> )	Para. 20



<i>A/CN.9/328, annex I</i>	<i>A/CN.9/318, annex</i>	<i>Source of modifications (paragraph numbers refer to this report. WP.41 refers to A/CN.9/WG.IV/WP.41)</i>
8(2)	3(1)	
8(3)	3(2)	
8(4) Variant A		Drafting Group
8(4) Variant B	5(4)	
9(1)	7(1)	Reworded by Drafting Group
9(2)	7(3)	
9(3)	7(5)	
9(4)		
10(1)-(7)		Para. 82
10(8)	8(6)	Paras. 112-113
Chapter III (Title)		Paras. 102-103
11 <i>chapeau</i>	5(3)	Drafting Group
11(a)	5(3)(c)	Drafting Group inserted "less than" in place of "different from"
11(b)	5(3)(b)	
12(1)	9(1)	Para. 131
12(2)-(5)(b)	9(2)-(5)(b)	"Value date" deleted in (4)(b)
12(5)(c)	9(5)(c)	Para. 139
12(5)(d)	9(5)(d)	Para. 143
12(6)	5(1 <i>bis</i> )	Reworded by Drafting Group
12(7)-(8)	9(6)-(7)	
13	10	
14	11	
15	12	

**B. International credit transfers: comments on the draft Model Law on International Credit Transfers: report of the Secretary-General\***  
(A/CN.9/WG.IV/WP.41) [Original: English]

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\*Working paper submitted to the Working Group on International Payments at its nineteenth session.

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## INTRODUCTION

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

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

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

4. The revised draft requested by the Working Group was published in A/CN.9/WG.IV/WP.39, accompanied by a commentary. Portions of articles 1 to 6 were considered by the Working Group at its eighteenth session held at Vienna from 5 to 16 December 1988. The text of the articles revised by the Working Group at that session, as well as those that it did not consider, was published in the annex to the report of the session (A/CN.9/318).

5. This report contains a commentary on the draft articles, indicating their history and their relation to other provisions.

6. A companion report, A/CN.9/WG.IV/WP.42, contains a discussion of the main issues to be decided in preparing the final text of the draft articles.

## COMMENTS ON THE DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS

### *Comments*

1. The Working Group decided at its eighteenth session that the words "Model Law" should be used in the title to reflect the fact that the text was for use by national legislators and that the text should not for the time being be in the form of a convention (A/CN.9/318, paras. 12 and 13).

2. The use of the words "Credit Transfers" reflected the decision that only credit transfers and not debit transfers should be included (A/CN.9/318, para. 14). This decision is set forth as a rule in article 1(1). Credit transfers are defined in article 2(a).

3. The word "electronic" is not used in the title as a result of the decision that the Model Law would be applicable to paper-based credit transfers as well as those made by electronic means (A/CN.9/318, paras. 15 to 17).

4. The Working Group decided that the Model Law should be restricted to international credit transfers and that that decision should be reflected in the title (A/CN.9/318, para. 18). The criteria for determining whether a credit transfer is international are to be found in article 1.

## CHAPTER I. GENERAL PROVISIONS

### Article 1. *Sphere of application\**

(1) This law applies to credit transfers where the originator's bank and the beneficiary's bank are in different countries.

(2) For the purpose of determining the sphere of application of this Law, branches of banks in different countries are considered to be separate banks.

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

## Comments

### *Internationality of a transfer*

1. As indicated by the title, the Model Law will apply only to credit transfers that are international. The test of internationality in paragraph (1) is that the originator's bank and the beneficiary's bank are in different countries.

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

3. The rule that the Model Law does not apply where the originator and the beneficiary have their accounts in the same bank applies as well to a bank that effects a transfer for its own account. Such a bank is an originator and not an originator's bank. Similarly a bank that receives credit for its account is a beneficiary and not a beneficiary's bank. Therefore, a credit transfer by Bank A for its own account to Bank B for its account made by instructing their mutual correspondent Bank C to debit and credit the appropriate accounts held with it, is not an international credit transfer and the Model Law would not apply even if the three banks were in different States. However, if the transfer was to Bank B for the credit of its customer, Bank B would be the beneficiary's bank. The transfer would be international if Bank B and Bank C were in different States. If it is considered desirable for the Model Law to apply whenever two banks are involved in different States, consideration could be given to introducing a definition of originator's bank as "(1) the receiving bank to which the payment order of the originator is issued if the originator is not a bank or (2) the originator if the originator is a bank" with a similar definition of "beneficiary's bank". If this suggestion is adopted, drafting changes involving the use of the term "originator's bank" would have to be made in articles 2(a), 5(3)(c), 7(1)(a) and 7(1)(d). Similar drafting changes would have to be considered in respect of "beneficiary's bank".

4. In some cases involving a transfer from a customer's account in a financial institution in State A to an account in a financial institution in State B, application of this Law will depend on whether both financial institutions are considered to be banks under the definition of a bank in article 2(e). If either financial institution was determined not to be a bank because it did not as an ordinary part of its business engage in credit transfers for other persons, the other financial institution would be both the originator's bank and the beneficiary's bank and the Model Law would not apply. Such a situation might arise where one of the financial institutions was a broker which would, on instructions of a customer, transfer a credit balance in a customer's brokerage account but which did not engage in credit transfers for its customers as an ordinary part of its business. See comments 10 and 11 to article 2.

5. A determination as to whether a credit transfer was international would also depend on how the transfer was structured. An example was given in the eighteenth session of the Working Group where the originator's bank in State A reimbursed the beneficiary's bank in State B by several different means. It was stated that these different means of reimbursing the beneficiary's bank for the transfer would determine whether some or all of the activities comprising the transfer would be considered to be international and fall within the sphere of application of the Model Law or would be considered to be domestic and fall outside of it (A/CN.9/318, paras. 25-26). This did not seem to be appropriate since the transfer would otherwise be identical from an economic point of view. Although the definition of a credit transfer in article 2(a) as comprising "a complete movement of funds from the originator to the beneficiary" might lead to the result that the Model Law would apply to all elements of a credit transfer that was international under article 1, the provision on the territorial application of the Law might lead to a different result. See comment 8, below.

6. International credit transfers may be denominated in the currency of the country where the originator's bank is located, in the currency of the country where the beneficiary's bank is located, or in some other currency or unit of account. If the originator's bank and the beneficiary's bank were in the same country, the Model Law would not apply to the transfer even if it was denominated in the currency of a third country. This result was adopted because, while the settlement between the originator's bank and the beneficiary's bank might have to pass through banks in the country of the currency in which the transfer was denominated, it may also be possible for settlement to be effected within the country where the two banks are located (A/CN.9/318, para. 21).

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

8. Since the Model Law is being prepared for international credit transfers, questions of conflict of laws naturally arise. Draft provisions on the territorial application of the Law are contained in article 12. Further consideration is given to the question in the companion report, A/CN.9/WG.IV/WP.42.

### *Consumer transfers*

9. The Working Group decided at its eighteenth session that the Model Law should apply to all international credit transfers, including transfers made for consumer purposes.

Not only would this preserve the basic unity of the law, it would avoid the difficult task of determining what would be a credit transfer for consumer purposes. That was also thought to be of importance since special consumer protection legislation affecting credit transfers currently exists, and could be envisaged in the future, in only some of the countries that might consider adopting the Model Law.

10. At the same time, it was recognized that the special consumer protection legislation that exists in some countries, and that may be adopted in others, could be expected to affect some international credit transfers as well as domestic credit transfers. To accommodate this possibility, the footnote to article 1 was adopted to indicate that the Model Law would be subject to any national legislation dealing with the rights and obligations of consumers, whether the provisions of that legislation supplemented or contradicted the provisions of the Model Law (A/CN.9/318, paras. 30 to 33).

#### *Effect of contractual agreement*

11. At its eighteenth session the Working Group decided that the extent to which the Model Law would be subject to the contrary agreement of the interested parties would be considered in connection with the individual provisions (A/CN.9/318, para. 34). In the current draft mention of the effect of contractual rules is made in articles 3(1), 4(2)(b), 5(1), 5(4)(a), 6(2)(a), 7(1)(a), 9(6), 11(1), 11(3), 12(1) and 12(2).

#### *Article 2. Definitions*

(a) "Credit transfer" means a complete movement of funds from the originator to the beneficiary pursuant to a payment order received by the originator's bank [directly] from the originator. A credit transfer may involve one or more payment orders.

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

(c) "Beneficiary" means the ultimate person intended to receive the funds as a result of a credit transfer.

(d) "Sender" means the person who sends a payment order including the originator and any sending bank.

(e) "Bank" means a financial institution which, as an ordinary part of its business, engages in credit transfers for other persons.

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

(g) "Intermediary bank" means any bank executing a payment order other than the originator's bank and the beneficiary's bank.

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

(i) "Payment order" means a message, whether written or oral, that contains either explicitly or implicitly at least the following data:

(i) an order to the receiving bank to pay, or to cause another bank to pay, to a designated person a fixed or determinable amount of money;

(ii) identification of the sender;

(iii) identification of the receiving bank;

(iv) the amount of the transfer, including the currency or the unit of account;

(v) identification of the beneficiary;

(vi) identification of the beneficiary's bank.

(j) "Authentication" means a procedure to determine whether all or part of a payment order is authorized, and which is the product of an agreement.

(k) "Cover" means the provision of funds to a bank to reimburse it for a payment order sent to it. The provision of cover might precede or follow execution of the order by the receiving bank.

(l) "Execution date" means the date when the receiving bank is to execute the payment order, as specified by the sender. When no execution date is stated on a payment order, the execution date of that order shall be deemed to be the date the order is received, unless the nature of the order indicates that a different execution date is appropriate.

(m) "Pay date" means the date when funds are to be at the disposal of the beneficiary, as specified by the originator.

(n) "Value date" means the date when funds are to be at the disposal of the receiving bank.

#### *Comments*

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

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

#### *"Credit transfer"*

3. The definition is based upon the definition of "funds transfer" in ISO 7982-1. The words "pursuant to a payment order received by the originator's bank [directly] from the originator" was added by the Working Group at its eighteenth session as a means of clarifying the difference between a credit transfer and a debit transfer (A/CN.9/318, para. 36). The word "directly" was placed in square brackets because of a concern that it might exclude some types of transfers that should be considered to be credit transfers.

4. At the eighteenth session of the Working Group concern was expressed about the use of the words "complete movement of funds" (A/CN.9/318, para. 37). These words form part of the ISO definition and no special examination was given to them by the Working Group. They would seem to indicate that the term "credit transfer" includes the entire set of actions from the issue of the payment order by the originator through credit to the account of the beneficiary, or other action leading to completion of the transfer. These words also indicate that reimbursement of the beneficiary's bank and any intermediary banks is part of the transfer. Potentially, therefore, these words have an important effect on the sphere of application of the Model Law. See comment 5 to article 1.

5. The second sentence refers to "one or more payment orders" rather than to one or more "funds transfer transactions" as in ISO 7982-1 or to one or more "segments", as in the draft before the Working Group at its eighteenth session. While the change in wording gives a narrower focus to the sentence, it would not seem to narrow the practical effect of the sentence.

*"Originator"*

6. The definition differs from the wording of the definition in ISO 7982-1, but not from its meaning. It was approved by the Working Group at its seventeenth and eighteenth sessions (A/CN.9/317, para. 32; A/CN.9/318, para. 41). Under the definition a bank that issues a payment order for its own account is an originator. See comment 3 to article 1 for the consequences on the sphere of application of the Model Law and for a suggestion as to a definition of "originator's bank" and of "beneficiary's bank".

*"Beneficiary"*

7. The definition differs from the wording of ISO 7982-1 in that a person whose account is credited in error is not a beneficiary (A/CN.9/318, para. 42). Although it is not stated in the definition, it would seem that the person intended to receive the funds is the person named as beneficiary in the originator's payment order. For the situation where the identity of the beneficiary is expressed both by words and by account number and there is a discrepancy between them, see article 3(2). Similar to the rule in regard to an originator, a bank may be the beneficiary of a transfer.

*"Sender"*

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

*"Bank"*

9. The Working Group at its eighteenth session agreed to use the word "bank" since it was short, well-known and

covered the core concept of what was intended (A/CN.9/318, para. 46). The definition in the Model Law will necessarily differ from that used in national legislation since there are different definitions in various countries and in some countries there are two or more definitions for different purposes.

10. The definition in ISO 7982-1 is that a bank is "a depository financial institution". The Working Group was of the view that the test as to whether a financial institution should have the rights and obligations of a bank under the Model Law should depend on whether "as an ordinary part of its business it engaged in credit transfers for others", rather than whether it engaged in the totally unrelated activity of taking deposits. As a result, some individual financial institutions that would not normally be considered to be banks, such as dealers in securities that engage in credit transfers for their customers as an ordinary part of their business, would be considered to be banks for the purposes of the Model Law.

11. The extension of the definition to such financial institutions has the potential to extend the sphere of application of the Model Law. If a given brokerage firm met the definition of a bank, it would be either an originator's bank or a beneficiary's bank (since it can be assumed that such institutions would not function as intermediary banks), and the payment orders given to it by its customer would be governed by this Law rather than by some other body of law. If another brokerage firm was not considered to be a bank under the definition, its payment order to a bank to make a transfer would be as an originator, even if in the given case the order was given for the account of one of its customers. The order from the customer to the brokerage firm would be outside the sphere of application of the Model Law. Compare comment 4 to article 1.

*"Receiving bank"*

12. Although the Working Group at its eighteenth session modified the wording of the definition from that found in ISO 7982-1, the meaning remained the same (A/CN.9/318, paras. 55 to 57). A bank that receives a payment order is a receiving bank even if the payment order was not addressed to it. (The problem of mis-directed payment orders is addressed in article 5(1 *bis*.) A bank to which a payment order is addressed but which does not receive it is not a receiving bank.

13. The receiving bank becomes responsible for a payment order only when that payment order has been delivered to it. The observation was made in the Working Group that if the word "delivered" was used, the definition might not cover the situation where the payment order was sent but not delivered (A/CN.9/317, para. 45). However, until the payment order has been delivered, the sender has not effectuated the communication.

*"Intermediary bank"*

14. The definition was proposed by the Working Group at its seventeenth session (A/CN.9/317, para. 41). It differs from the definition in ISO 7982-1 in three substantial

respects: first, it includes all banks other than the originator's bank and the beneficiary's bank, whereas ISO 7982-1 includes only those banks between the given receiving bank and the beneficiary's bank; secondly, ISO 7982-1 includes only those banks between the receiving bank and the beneficiary's bank "through which the transfer must pass if specified by the sending bank"; and thirdly, reimbursing banks are included in this definition, even though the transfer may be considered not to pass through them and they are not in the chain of payment orders from the originator to the beneficiary's bank. The definition was not considered by the Working Group at its eighteenth session.

#### *"Funds" or "money"*

15. The definition is modelled on the definition of "money" or "currency" contained in article 5(l) of the United Nations Convention on International Bills of Exchange and International Promissory Notes. However, it specifies that the term includes credit in an account, as is proper in the context of this Model Law.

16. In order to bring the definition closer to that in the Convention, the beginning portion might be drafted as follows:

"'Funds' or 'money' includes credit in an account kept by a bank and includes credit denominated in a monetary unit of account which is established . . ."

#### *"Payment order"*

17. In accordance with a suggestion made in the seventeenth session of the Working Group, the minimum data elements necessary to constitute a payment order have been included in the definition of the term (A/CN.9/317, para. 54). Inclusion of these data elements in the Model Law will have an educational function. Other data elements may be required by a particular funds transfer system (see comment 22, below). The sender's failure to include one of the necessary data elements will be a factor in allocating loss in case the transfer is not carried out, is carried out late or is carried out incorrectly.

18. Since a message may be considered not to be a payment order if any one of the listed data elements is omitted, consideration may be given to modifying the text as follows:

"'Payment order' means a message, whether written or oral, that contains an order to the receiving bank to pay, or to cause another bank to pay, to a designated person a fixed or determinable amount of money. A payment order is required to contain either explicitly or implicitly at least the following data:

- (i) identification of the sender;  
...."

19. Authentication has been deleted as a required data element in a payment order. It is, however, defined in subparagraph (j). In accordance with the suggestion at the seventeenth session of the Working Group, the consequences of a failure to authenticate a payment order or other message are considered in article 4 on the obligations of a sender (A/CN.9/317, para. 55).

20. Although there was some hesitancy in the Working Group as to whether it was necessary to specify that the payment order could be either written or oral (A/CN.9/317, para. 53), the words have been retained since they seem to add clarity to the definition.

21. The fact that the required data elements could be contained in the payment order "either explicitly or implicitly" would also seem to make it clear that communicating parties can agree on specific formats, as was suggested in the Working Group (A/CN.9/317, para. 53). The designation of the currency or unit of account may be implicit where the funds transfer system used is restricted to a particular currency or unit of account.

22. A preliminary version of ISO Draft Proposal 7982-2, "Universal Set of Data Segments and Elements for Electronic Funds Transfer Messages" contained in document ISO/TC68/SC5/N230, dated 8 August 1988, proposes a set of mandatory data elements. Under the proposal, those mandatory data elements that would always be required to appear in the message are labelled "Mandatory Explicit". The data elements that would be required either to appear in the message or be derivable from another mandatory data segment and/or data element in the message or from the processing conventions of the system used are referred to in the proposal as "Mandatory Implicit". The document lists several data elements as being either mandatory explicit or mandatory implicit that are not set forth in the current definition of payment order, e.g. the date and time the message was delivered by a communications service.

#### *"Authentication"*

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

24. The definition makes it clear that an authentication of a payment order does not refer to formal authentication by notarial seal or the equivalent, as it might be understood in some legal systems. The definition also differs from the definition of "message authentication" in ISO 7982-1 in that authentication as here defined does not include the aspect of validating "part or all of the text" of a payment order. This is appropriate, even though most electronic authentication techniques do both, since this Model Law also applies to paper-based payment orders. However, a definition of authentication that included validation of part or all of the text might be desirable if it was thought desirable to extend the result of article 4(2) to the content of the payment order. See comments 11 and 12 to article 4.

25. The definition as adopted by the Working Group at its eighteenth session includes the provision that the authentication procedure is the product of an agreement between the sender and the receiving bank. However, under article 4(2) the authentication procedure must be

"commercially reasonable" in order for a purported sender to be bound by an unauthorized payment order even if the authentication used was agreed to by the sender.

#### "Cover"

26. The first sentence has the same meaning, though not the same wording, as the definition of "cover payment" in ISO 7982-1. The second sentence was added at the suggestion of the Working Group at its seventeenth session (A/CN.9/317, para. 33).

27. Concern over use of the word "cover" has been expressed in the Working Group on several occasions. In the current draft the word is used in articles 4(2)(b) (different meaning), 6(2)(a) and 6(2)(c) variant A.

#### "Execution date"

28. There is no equivalent term in ISO 7982-1. The execution date is the date on which a given payment order is to be executed as specified by the sender. Since a credit transfer may require several payment orders, each of those payment orders may have an execution date, and each of the execution dates may be different.

29. At the eighteenth session of the Working Group the second sentence, which was previously part of article 7(1)(b), was added to the definition (A/CN.9/318, paras. 104, 106). Article 7(1)(b) continues to provide a rule for determining the execution date if no value or pay date is specified on the payment order.

30. The rule that, absent other indication, the execution date of a payment order is the date the order is received would seem to be an appropriate rule for international credit transfers.

31. The most obvious indication of an execution date other than the date the order was received is the provision of an explicit execution date or value date or, in the case of the beneficiary's bank, of a pay date. In addition, the execution date is not the date received if "the nature of the payment order indicates that a different execution date is appropriate". This phrase, which was first added to the rule before the sphere of application of the Model Law was restricted to international credit transfers, can be easily applied to bulk credit transfers of low value sent through a system that operates on a set time schedule, such as execution on the third day after receipt of the payment orders on magnetic tape. It may be less often applicable to international credit transfers.

#### "Pay date"

32. The term "pay date" is also used by ISO 7982-1 to indicate the date when the funds are to be available to the beneficiary. ISO 7982-1 uses the term "payment date" to indicate the date on which a payment was executed.

33. The definition of "pay date" differs from that in ISO 7982-1 in that in the latter the pay date is the "date on which the funds are to be available to the beneficiary for withdrawal in cash". In the Model Law definition the pay date is the date "when the funds are to be at the disposal

of the beneficiary". The definition leaves open the question when and under what circumstances the funds are at the disposal of the beneficiary, but they may be at the disposal of the beneficiary even though they are not available for withdrawal in cash. The most obvious example is when the transfer is in a unit of account that may be at the disposal of the beneficiary for further transfer but not available in cash either as a unit of account or, perhaps, in the local currency.

#### "Value date"

34. The definition is identical to that in ISO 7982-1. As in respect of "pay date", the question is left open as to when and under what circumstances the funds are at the disposal of the receiving bank.

#### Article 3. *Discrepancies within a payment order*

(1) If there is an inconsistency in a payment order between the words and figures that describe the amount of money, the receiving bank is required to notify the sender of the discrepancy unless the sender and the receiving bank had agreed that the receiving bank would rely upon either the words or the figures, as the case may be.

(2) Where the beneficiary is described by both words and figures, and the intended beneficiary is not identifiable with reasonable certainty, the beneficiary's bank must notify, within the time prescribed in article 7, paragraph (4), its sender, and also the originator's bank if it is identified on the payment order.

#### Comments

1. Article 3 deals only with the responsibility of a receiving bank when it receives a payment order that expresses either the amount to be transferred or the identification of the beneficiary in both words and figures and there is a discrepancy between the two. Allocation of loss arising out of the actions of a fraudulent third party that do not result in such a discrepancy are to be covered in the provisions on liability (A/CN.9/318, para. 63). Compare comment 24 to article 2 and comments 11 and 12 to article 4.

2. The current text was adopted by the Working Group at its eighteenth session (A/CN.9/318, paras. 60 to 69).

#### Paragraph (1)

3. If the amount is expressed in both words and figures and there is a discrepancy, the receiving bank is required to notify the sender. If the receiving bank does not do so and it acts upon the incorrect amount, it is responsible for the consequences, even if it had no subjective awareness of the discrepancy.

4. The rule is expressed in general terms to apply to payment orders between any sender and receiving bank. However, it was the expectation in the Working Group that paragraph (1) would apply in fact only between the originator and the originator's bank, since interbank payment orders in electronic form transmit the amount of the transfer in figures only (A/CN.9/318, paras. 61 and 63).

5. Paragraph (1) makes the general rule subject to the agreement of the sender and the receiving bank that the receiving bank will act upon either the words or the figures, as the case may be. Such an agreement could be anticipated between a bank and its customers. If such an agreement exists, it could be anticipated to provide that the bank would act upon the amount in figures.

*Paragraph (2)*

6. Paragraph (2) applies only to a payment order received by the beneficiary's bank containing a discrepancy between the identification of the beneficiary in words and its identification in figures. No bank prior to the beneficiary's bank can be expected to have the information to be able to determine that such a discrepancy exists.

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

8. In order to reduce to a minimum the time during which the transfer is suspended, the notification to both the sender and the originator's bank must be done within the time specified in article 7(4), i.e. on the day the decision is made, but not later than the day the receiving bank was required to execute the order. It is anticipated that within a reasonable time the beneficiary's bank would receive further instructions as to the proper identification of the beneficiary, or an indication that the transfer was fraudulent.

(b) the amount of the order is covered by a withdrawable credit balance or authorized overdraft in an appropriate account of the sender with the receiving bank or there is an agreement between the sender and the receiving bank that such payment orders are to be executed despite the absence of such balances or overdrafts, and

(c) the receiving bank complied with the authentication.

(3) *Variant A*

A purported sender [that is not a bank] is, however, not bound by a payment order under paragraph (2) if

(a) the actual sender was a person other than a present or former employee of the purported sender, and

(b) the actual sender had gained access to the authentication procedure without fault on the part of the purported sender.

*Variant B*

No sender may become bound under paragraph (2) if the sender proves that the payment order was executed by

(a) a present or former employee or agent of the receiving bank, or

(b) a person acting in concert with a person described in (a), or

(c) any other person who, without the sender's authorization, obtained confidential information about the authentication from a source controlled by the receiving bank, regardless of fault.

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

## CHAPTER II. DUTIES OF THE PARTIES

### Article 4. *Obligations of sender*

(1) *Variant A*

A purported sender is bound by a payment order, if he authorized it or if it was issued by a person who, pursuant to the applicable law [of agency], otherwise had the power to bind the purported sender by issuing the payment order.

*Variant B*

A purported sender is bound by a payment order if it was issued by the purported sender or by another person who had the authority to bind the purported sender.

(2) Notwithstanding anything to the contrary in paragraph (1), when a payment order is subject to authentication, a purported sender of such an order is bound if:

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

### *Comments*

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

*Paragraph (1)*

2. Paragraph (1) states the basic rule that a purported sender is bound by a properly authorized payment order. Concern was expressed at the eighteenth session of the Working Group to find a means to express the rule without referring to the law of agency so as not to be faced with the differences in legal systems on this issue. Variant B was proposed as a formulation to avoid that problem (A/CN.9/318, paras. 72, 73 and 83).

*Paragraph (2)*

3. Paragraph (2) has been drafted as an exception to paragraph (1), but from the viewpoint of banking operations it provides the basic rule. In almost all cases a



payment order must be authenticated. Proper authentication indicates proper authorization and the receiving bank will act on the payment order. Even if the payment order was not properly authorized under paragraph (1), the purported sender is bound by the order if the three requirements of paragraph (2) are met.

4. The first requirement is that the authentication provided is commercially reasonable. The discussion in the Working Group proceeded on the basis that it was the receiving bank that determined the type of authentication it was prepared to receive from the sender. Therefore, it was the receiving bank's responsibility to assure that the authentication procedure was at least commercially reasonable. The sender and the receiving bank could not provide for a lower standard by agreement (A/CN.9/318, para. 75).

5. No attempt has been made to set a standard as to what constitutes a commercially reasonable authentication procedure. The standard would depend on factors related to the individual payment order, including such factors as whether the payment order was paper-based, oral, telex or data transfer, its amount and the identity of the purported sender. The standard as to what was commercially reasonable could be expected to change over time with the evolution of technology.

6. The second requirement, that the amount of the payment order is covered by a withdrawable credit balance or authorized overdraft in an appropriate account of the sender with the receiving bank, affords a protection for originators in some countries. By limiting the amount that can be debited to an account, a customer can limit the amount of potential loss. Such a limitation also furnishes to a limited degree an indication that an excessively large payment order may be in error or fraudulent.

7. The last clause was added to be sure that the provision would not cause problems in a net settlement system where a sending bank would have no account relationship with the receiving bank (A/CN.9/318, paras. 85-86). The clause would also seem to apply to the situation where a receiving bank was to receive reimbursement by credit in its account at a third bank. Furthermore, it was thought to apply to the situation in some countries where the agreements between banks and their customers provide that the bank is permitted, but not required, to create an overdraft when it receives a payment order from its customer (A/CN.9/318, paras. 84 and 86). However, the imperative nature of the words "are to be executed" may leave the latter case outside the clause as currently drafted.

8. The third requirement is that the receiving bank complied with the authentication. If the bank did not comply with the authentication but the payment order was authorized, the purported sender would be bound nevertheless under paragraph (1).

#### *Paragraph (3)*

9. The paragraph was prepared in two versions at the eighteenth session of the Working Group. In general, those who were in favour of placing on the receiving bank

the major risk that an authentication had been falsified by a known or unknown third person favoured variant A. This was said to be appropriate because it was the receiving bank that usually designed the authentication procedure (see comment 4). In general, those who were in favour of placing the major risk on the sender favoured variant B. This was said to be appropriate because it was the sender who chose the means of transmission of the particular payment order. Moreover, variant B would act as an incentive to senders to protect the authentication or encryption key in their possession (A/CN.9/318, paras. 88 to 90).

10. At the eighteenth session it was suggested that in order to compare better the advantages or disadvantages of the two variants, variant A should be re-written to state, as does variant B, what would have to be proven and by whom. Since even the supporters of variant A seemed to assume that it would be the sender who had the burden of proving the exonerating conditions (see A/CN.9/318, para. 91), the introductory words to variant A might read as follows:

"A purported sender [that is not a bank] is not bound under paragraph (2) if the purported sender proves that  
(a) ...".

#### *Altered payment orders*

11. It may be thought desirable to extend the principle of paragraphs (2) and (3) to situations in which the payment order as received by the receiving bank differs from the payment order as sent. The current rule is that the receiving bank is obligated only by the payment order it has accepted (article 5(3)(a)). Therefore, the sender bears the risk of any fraud or data corruption that may have occurred prior to reception of the payment order by the bank.

12. However, some of the procedures used to authenticate the source of a payment order can be used to verify some or all of the content of the order. When the use of such a procedure has been agreed between the sender and the receiving bank but the receiving bank does not comply with the procedure, it should bear any loss that may result from the failure to find that the content of the order is not correct.

#### *Paragraph (4)*

13. The distinction between the obligation of the sender to pay the receiving bank being created when the receiving bank accepts the payment order and the obligation to pay maturing on the execution date is relevant when the execution date is in the future. At the eighteenth session the use of the execution date as the date when the sender should be obligated to make the funds available to the receiving bank was questioned on the grounds that the execution date was defined in article 2(1) as the date the receiving bank was obligated to act and not the date the receiving bank had performed its obligation (A/CN.9/318, para. 104).

14. It can be doubted whether receiving banks will often accept payment orders for future execution prior to the

execution date, unless the sender has already paid for the order. However, if the receiving bank executes the payment order prior to the execution date, it accepts the order at the time of its execution. While the sender can no longer revoke the order (article 8(1) and (2)), and is obligated to pay for it, the receiving bank may not debit the sender's account or otherwise require payment for the order until the execution date. See, however, article 11(4).

#### Article 5. *Obligations of receiving bank*

(1) In the absence of an agreement otherwise,

(a) a receiving bank is not required to comply with the sender's payment order;

(b) a receiving bank that decides not to comply with a sender's payment order is required to notify the sender of its decision, within the time required by article 7, unless one of the reasons for non-compliance is insufficient funds.

If a receiving bank does not notify the sender within the required time that it will not comply, it may no longer give such notice and is bound to execute the order.

(1 *bis*) When a payment order is received that contains information which indicates that it has been misdirected, the receiving bank shall notify the sender of the misdirection. [If the receiving bank fails to notify, and the credit transfer is delayed, the receiving bank shall be liable:

(a) if there are funds available, for interest on the funds that are available for the time they are available to the receiving bank; or

(b) if there are no funds available, for interest on the amount of the payment order for an appropriate period of time, not to exceed 30 days.]

(2) Deleted

(3) A receiving bank other than the beneficiary's bank that accepts a payment order is obligated under that payment order:

(a) to issue a payment order, within the time required by article 7, to either the beneficiary's bank or an appropriate intermediary bank, that is consistent with the contents of the payment order received by the receiving bank and that contains the instructions necessary to implement the credit transfer in an appropriate manner;

(b) where a payment order consistent with the contents of the payment order issued by the originator and containing instructions necessary to implement the credit transfer in an appropriate manner is not issued to or accepted by the beneficiary's bank—to refund to its sender any funds received from its sender, and the receiving bank is entitled to the return of any funds it has paid to its receiving bank; and

(c) where a payment order is issued to a beneficiary's bank in an amount different from the amount in the payment order issued by the originator to the originator's bank—to assist the originator and each subsequent sending bank, and to seek the assistance of its receiving bank, to obtain the issuance of a

payment order to the beneficiary's bank for the difference between the amount paid to the beneficiary's bank and the amount stated in the payment order issued by the originator to the originator's bank.

(4) A beneficiary's bank that accepts a payment order fulfils its obligations under that payment order

(a) if the beneficiary maintains an account at the beneficiary's bank into which funds are normally credited, by, in the manner and within the time prescribed by law, including article 7, or by agreement between the beneficiary and the bank

(i) crediting the account,

(ii) placing the funds at the disposal of the beneficiary, and

(iii) notifying the beneficiary; or

(b) if the beneficiary does not maintain an account at the beneficiary's bank, by

(i) making payment by the means specified in the order or by any commercially reasonable means, or

(ii) giving notice to the beneficiary that the bank is holding the funds for the benefit of the beneficiary.

(5) The receiving bank is not bound to follow an instruction of the sender specifying an intermediary bank, funds transfer system or means of transmission to be used in carrying out the funds transfer if the receiving bank, in good faith, determines that it is not feasible to follow the instruction or that following the instruction would cause excessive delay in completion of the funds transfer. The receiving bank acts within the time required by article 7 if it, in good faith and in the time required by that article, enquires of the sender as to the further actions it should take in light of circumstances.

#### *Comments*

##### *Paragraph (1)*

1. As a general principle the receiving bank is neither required to comply with a payment order it receives nor is it required to justify its non-compliance. However, this rule is subject to contrary agreement of the sender and receiving bank.

2. Nevertheless, since the expectation is that a receiving bank will comply with a payment order it has received, it must notify the sender of its decision not to comply.

3. The only exception to the requirement that the sender be notified is that the receiving bank need not do so if one of its reasons for non-compliance is insufficient funds. This exception applies to several different fact situations that, perhaps, should be treated differently. Its clearest application is where the originator does not have a sufficient balance or line of credit to support a debit to its account in the originator's bank. It can be assumed that the originator is aware of its account balance and need not be informed that it is insufficient (A/CN.9/317, para. 82).

4. However, the exception also applies to payment orders issued by the originator's bank or an intermediary bank to

an intermediary bank or to the beneficiary's bank. There may be insufficient funds because the sending bank's balance in its account with the receiving bank is insufficient. There may be insufficient funds because the sending and receiving banks are in a net settlement arrangement and the sending bank's intra-day net credit limit has been reached. There may also be insufficient funds because the receiving bank has not received notice of the credit to its account with its correspondent bank. From the viewpoint of the receiving bank, the situation is the same as when it is the originator's account that is insufficient. From the viewpoint of the originator the situation is quite different since the originator has no way to know that the credit transfer is being delayed. Especially in the case of delayed notice of credit where the difficulty may be unknown to the sending bank, it may be thought that the credit transfer should not be delayed indefinitely without notice to it.

5. If a receiving bank is required to give a notice but does not give it within the time required by article 7, it may no longer give such notice and is bound to execute the order. Failure to execute the order would make the receiving bank subject to the liabilities set forth in article 9.

6. Furthermore, according to article 6(1)(b), if the receiving bank is not the beneficiary's bank, it has accepted the order, with the consequence that it has the obligations of article 5(3). The current text of article 6(2) does not have a similar rule when the receiving bank is the beneficiary's bank.

*Paragraph (1 bis)*

7. The Working Group decided at its eighteenth session that a receiving bank should be required to notify the sender when the payment order received indicates that it had been misdirected. The imposition of such a duty will help assure that the funds transfer system will function as intended (A/CN.9/318, para. 122). The duty applies whether or not the sender and the receiving bank have had any prior relationship.

8. In most cases of breach of duty under the Model Law the harm that is suffered is reasonably clear and the remedy of the injured party can be left to the general provisions of article 9. That is not true in respect of a breach of the duty to notify the sender of a misdirected payment order. Therefore, the Working Group decided to prepare a special provision and, for the time being, to retain it in square brackets in article 5(1 bis). It is expected that it will subsequently be transferred to an appropriate location in article 9.

*Paragraph (3)*

9. At the eighteenth session of the Working Group former paragraphs (2) and (3) were deleted and the current paragraph (3) was adopted (A/CN.9/318, paras. 151 to 154). The new organization of article 5 includes within it only the provisions relevant to the actions a receiving bank should take to carry out the credit transfer and the actions necessary to rectify the situation if problems arise. This paragraph, dealing with the obligations of a receiving bank other than the beneficiary's bank that has accepted a payment order, groups those obligations into three cate-

gories corresponding to the three subparagraphs: (a) to send a proper payment order to a proper bank within the proper time, (b) to refund what it had been paid by its sender if the credit transfer is not successfully carried out, and (c) to assist in seeing that a credit transfer that was originally carried out for an amount less than that provided in the originator's payment order is successfully carried out for the proper amount.

10. The first obligation of the receiving bank set out in subparagraph (3)(a) is the normal obligation of the receiving bank to execute the order it has accepted. When it sends its own payment order to its receiving bank it becomes a sending bank and undertakes the obligations of such a bank under article 4.

11. Two different situations are envisaged under subparagraph (3)(b): no payment order was accepted by the beneficiary's bank (perhaps because none was issued to it) and a payment order was accepted but it was inconsistent with the originator's payment order in some manner other than that it was for too small an amount. Subparagraph (3)(b) as drafted would also apply where the payment order was for too small an amount, but in such a case the subparagraph should apply only to the deficiency and only if subparagraph (3)(c) does not remedy the situation.

12. The reason a credit transfer is not carried out successfully may be that the indication of the beneficiary or of the beneficiary's bank was incorrect by reason of error or fraud. Other reasons why a credit transfer may fail to be carried out successfully are that the imposition of currency restrictions prevents the transfer from being made, for some reason a transfer cannot be made to the beneficiary's bank or to the country where the beneficiary's bank is located, the beneficiary's bank refuses to accept the payment order addressed to it or the account of the beneficiary is no longer open to receive credit transfers. In most cases where the indication of the incorrect beneficiary or beneficiary's bank was the result of an error, it could be expected that the error would be corrected and the credit transfer would be carried out as directed, though perhaps late. Where resolution of the error or fraud calls for reversal of the transfer, article 8(7) provides that the beneficiary's bank may reverse a credit if it was entered to an account other than the account specified by the originator. Subparagraph (3)(b) provides the mechanism for passing the refund up the chain of banks.

13. If the credit to the beneficiary's account is for an amount greater than the amount specified in the originator's payment order, subparagraph (3)(b) of this article and article 8(7) would permit recovery of the excess payment.

14. Subparagraph (3)(b) implements the policy decision that has been repeatedly affirmed by the Working Group that the originator can hold its bank responsible for proper performance of the credit transfer. While the originator's bank may properly debit the originator's account once it has executed the originator's payment order, it must re-credit the originator's account if the credit transfer is not properly carried out. In turn, it has a right of reimburse-

ment from its receiving bank for any funds it has paid to that bank. As a result of this basic policy decision, the Working Group rejected a suggestion that the obligation of a receiving bank should be to assign to its sender the right of reimbursement it would have from its receiving bank (A/CN.9/318, para. 153). The result of that suggestion would have been to place on the originator the obligation to pursue its claim for reimbursement from a subsequent bank in the transfer chain and to bear the risk that the reimbursement could not be fully recovered.

15. Although subparagraph (3)(c) refers to a payment order issued to the beneficiary's bank in an amount different from the amount in the payment order issued by the originator to the originator's bank, it would apply only if the amount in the payment order to the beneficiary's bank was for a lesser amount. Consideration might be given to extending the subparagraph to the case where no payment order has been issued to the beneficiary's bank. The obligation on the receiving bank to assist in seeing that the credit transfer is completed for the correct amount does not place the receiving bank at risk. A credit transfer completed under subparagraph (3)(c) will normally be late in respect of the original deficiency in amount and there may be liability for the delay under article 9.

#### *Paragraph (4)*

16. Except for the opening words the Working Group did not have the time to consider paragraph (4) at its eighteenth session. The opening words were modified to make them consistent with the opening words of paragraph (3) (A/CN.9/318, para. 156).

17. The Working Group has not as yet decided on the extent to which the Model Law should be concerned with the relationship between the beneficiary and the beneficiary's bank. The propriety of including paragraph (4) within the Model Law might depend upon the ultimate decision as to whether the credit transfer was considered to be completed, with the legal consequences that would follow, when the beneficiary's bank accepted the payment order or only when the beneficiary's bank credited the beneficiary's account or performed a similar act. In the first case paragraph (4) might not be needed, leaving those rules to the law that governed the account relationship. In the latter case, paragraph (4) would fulfil an important role in defining the obligations of the beneficiary's bank in regard to the credit transfer. Furthermore, if it was felt useful to provide in the Model Law when the funds were available to the beneficiary, thereby fulfilling the obligations of the various banks when the originator has specified a "pay date", paragraph (4) would be relevant (see articles 2(m) and 8(1)(c) and (d)).

18. While paragraph (4) sets forth the type of actions to be taken, it sets out neither the manner in which they are to be accomplished nor the time when they are to be accomplished. Those two elements are left to other rules of law or to agreement between the beneficiary and the bank. The single exception is a reference to certain provisions in article 7 as to when the beneficiary's bank must act.

#### *Paragraph (5)*

19. Although a receiving bank is normally bound to follow any instructions in the payment order specifying an intermediary bank, funds transfer system or means of transmission, it can happen that it is not feasible to follow the instructions or that doing so would cause excessive delay in completing the transfer. This paragraph gives the receiving bank an opportunity to make such a determination, so long as it does so in good faith. As an alternative the receiving bank can enquire of the sender as to the actions it should take, but it must do so within the time required by article 7.

#### *Article 6. Acceptance of a payment order*

(1) A receiving bank that is not the beneficiary's bank accepts the sender's payment order at the earliest of the following times:

- (a) when it sends a payment order intended to carry out the payment order received; or
- (b) when it should have given the notice required by article 5(1).

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

- (a) when the bank receives the payment order, provided that the sender and the bank have agreed that the bank will execute payment orders received from the sender without notification that cover is in place [or a course of action to that effect has been established between them];
- (b) Deleted
- (c) *Variant A*

When the bank credits the beneficiary's account [without reserving a right to reverse the credit if cover is not furnished] or otherwise pays the beneficiary;

#### *Variant B*

Deleted

#### *Variant C*

When the bank gives notice to the beneficiary that it has the right to withdraw the credit or the funds;

- (d) when the bank otherwise applies the credit as instructed in the payment order;
- (e) when the bank applies the credit to a debt of the beneficiary owed to it or applies it in conformity with an order of a court.

#### *Comments*

1. Since a receiving bank, including the beneficiary's bank, is generally not required to comply with the sender's payment order, obligations of the receiving bank (other than certain obligations to give notice) arise only if the receiving bank has accepted the payment order (article 5(3) and (4)). In the current draft acceptance of the payment order is also used to determine when the sender's obligation to pay the receiving bank for the payment order arises (article 4(4)), to place a limit on the right to revoke or amend a payment order (article 8(3)), to determine

when the obligation of the debtor is discharged (article 11(2)) and to provide a rule for deeming that an account has been debited (article 11(4)).

2. Article 6 sets forth the actions of the receiving bank that constitute acceptance. Article 7 provides the time within which a payment order must be accepted or notice given. Article 9 sets forth the liability of a person who has failed to perform his obligations, including obligations undertaken by acceptance of the payment order.

3. The use of the concept of "acceptance" was discussed at length in the eighteenth session of the Working Group without final resolution as to whether it should be retained. In favour of its retention it was pointed out that the concept served the purpose of describing in a single word a number of different actions of different receiving banks, so that the word might be used in various substantive provisions. In opposition it was suggested that it would be better to rely on the execution of the payment order by the receiving bank as the legally significant event. It was also suggested that use of the term "acceptance" caused difficulties in many legal systems because it seemed to suggest that a contract was created as a result of the receiving bank's actions (A/CN.9/318, paras. 127 to 130). The significance of the use of the concept of acceptance is discussed further in the companion report, A/CN.9/WG.IV/WP.42.

#### *Paragraph (1)*

4. The usual means by which a receiving bank that is not the beneficiary's bank accepts a payment order is to send its own payment order intended to carry out the payment order received. If the payment order sent is consistent with the payment order received, the undertaking of obligations by the receiving bank and the execution of the most important of those obligations under article 5(3)(a) are simultaneous. However, a receiving bank accepts a payment order even when it sends an order for the wrong amount, to an inappropriate bank or for credit to the account of the wrong beneficiary so long as the payment order sent was intended to carry out the payment order received. If such an inconsistent payment order is sent, the undertaking of obligations and the failure to carry out those obligations are also simultaneous.

5. Acceptance of a payment order occurs through passage of time when a receiving bank is required to give notice under article 5(1)(b) and fails to do so in the required period of time. Article 5(1)(b) provides that the receiving bank may no longer give such notice and is bound to execute the order. Article 6(1)(b) provides that the receiving bank has accepted the payment order with the consequences that follow upon acceptance.

6. In addition to the two means of accepting a payment order set forth in paragraph (1), article 4(4) anticipates that a receiving bank might accept on day 1 a payment order that has an execution date of day 5 (see A/CN.9/318, para. 100). It could be expected that an acceptance in such a situation would be in the form of an overt act on the part of the receiving bank, perhaps by notifying the credit party of its intention to execute the order.

#### *Paragraph (2)*

7. Acceptance of the payment order by the beneficiary's bank is of particular importance because it signals the essential completion of the credit transfer. The sender can no longer revoke or amend the payment order (article 8(3)), the beneficiary's bank is indebted to the beneficiary and the underlying obligation, if there is one, is discharged (article 11(2)).

8. The discussion of paragraph (2) in the eighteenth session of the Working Group proceeded along two lines. The first line of approach was to discuss and modify the draft text before the Working Group in A/CN.9/WG.IV/WP.39 (A/CN.9/318, paras. 135 to 141). Following that discussion, a small working party prepared a new draft that did not use the word "accept" but set forth the situations in which the beneficiary's bank would be obligated to execute the payment order. The Working Group noted the proposal but did not have time to consider it in substance (A/CN.9/318, paras. 142 and 143). Therefore, the text remains as presented to the Working Group and modified by it at its eighteenth session.

9. If the bank and the sender have agreed that the bank will execute payment orders received from the sender without notification that cover is in place, the major reason for the bank's failure to accept the order no longer exists. Subparagraph (a) provides that when such an agreement exists, the beneficiary's bank accepts the payment order when it receives it. The bank could not reject the payment order after reception for any reason. Former subparagraph (b) gave the same result if the beneficiary's bank received notice that cover was available.

10. That result raised concerns in the eighteenth session of the Working Group where it was emphasized that under all circumstances even a beneficiary's bank should have the opportunity to reject a payment order if, for example, it was not satisfied with the cover (relevant to former subparagraph (b)), it believed the particular payment order was part of a money laundering scheme or the beneficiary had instructed the bank not to accept the particular order or that class of orders. As a result former subparagraph (b) was deleted and a decision was made to add a volitional requirement to subparagraph (a). However, in view of the effort to draft an alternative provision, the proposed addition was not undertaken at the eighteenth session of the Working Group.

11. The Working Group noted that variants A and C of subparagraph (c) were compatible and might both be retained in the Model Law. So as not to introduce new forms of drafting at this stage, they have been temporarily retained in their original form. The draft prepared in the Working Group that was not considered for lack of time suggested that the beneficiary's bank should also be considered to become bound to execute the payment order when the bank prepares a credit to be entered into the account or when a provisional or reversible credit becomes irrevocable or irreversible except for purposes of correcting an error (A/CN.9/318, para. 142).

Article 7. *Time to accept and execute payment order or give notice*

(1) A receiving bank that is obligated under article 5 to accept a payment order or to give notice that it will not do so must accept and execute the payment order or give the required notice within the time consistent with the terms of the order, in particular, as follows:

(a) When a payment order states an execution date, the receiving bank is obligated to execute the order on that date. When the payment order states a value date but no execution date, the execution date shall be deemed to be the value date. Unless otherwise agreed, the receiving bank may not charge the sender's account prior to the execution date.

(b) When no value or pay date is stated on a payment order, the execution date of that order shall be deemed to be the date the order is received, unless the nature of the order indicates that a different date is appropriate.

(c) When a pay date is stated on the payment order accepted by the originator's bank, the obligation of the originator's bank is that the beneficiary's bank accept the payment order by that date. An intermediary bank that accepts a payment order with a pay date is obligated to use its best efforts to cause the beneficiary's bank to accept the payment order by that date. A beneficiary's bank that accepts a payment order on or before the pay date is obligated to place the funds at the disposal of the beneficiary on that date.

(d) When no pay date is stated on the payment order accepted by the originator's bank, the obligation of the bank is that the beneficiary's bank accept a payment order within an ordinary period of time for that type of order.

(2) A receiving bank that receives a payment order too late to execute it in conformity with the provisions of paragraph (1) nevertheless complies with those provisions if it executes the order on the day received regardless of any execution, value or pay date specified in the order.

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

(4) A notice that a payment order will not be accepted must be given on the day the decision is made, but no later than the day the receiving bank was required to execute the order.

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

7(1)(b) was deleted and added to the definition of "execution date" in article 2(b) (A/CN.9/318, paras. 104 to 106). At that time the Working Group decided that the rest of article 7(1)(b) would be considered later.

2. The second sentence of subparagraph (1)(a) considers a problem that raises considerable difficulties, i.e. the significance of a "value date" on a payment order. The definition of "value date" in article 2(n), "the date when funds are to be at the disposal of the receiving bank", is consistent with ISO 7982-1 and general international usage. However, in some countries it is understood that the receiving bank is expected to execute the payment order when it is received with value as of the value date while in other countries it is understood to be an instruction to execute the payment order only on the value date. This draft chooses the latter interpretation. While a uniform interpretation of this term would be of great importance, the choice of one or the other interpretation does not affect other provisions of the Model Law.

3. Subparagraph (1)(c) is consistent with the provision of article 9(2) that an originator's bank that accepts a payment order containing a pay date is responsible for the timely execution of the transfer. An intermediary bank is obligated only to use its best efforts.

4. The definition of "pay date" in article 2(m) says that it is the date the funds are to be at the disposal of the beneficiary. Subparagraph (1)(c) of this article is consistent with the general philosophy of the current draft of the Model Law that the originator's bank and the intermediary banks have fulfilled their obligations once the beneficiary's bank has accepted the payment order.

5. Although under article 11(2) any obligation of the originator to the beneficiary would also be discharged when the beneficiary's bank accepts the payment order received by it, the originator who has specified a pay date will often have other reasons for wishing the funds to be at the disposal of the beneficiary on that date. Therefore, subparagraph (1)(c) goes on to provide that the obligation of the beneficiary's bank is to make the funds available on that date. The beneficiary's bank would be liable to its sender and to the originator if the bank failed to place the funds at the disposal of the beneficiary in accordance with the pay date. Such an obligation to the originator would seem to be appropriate even if the credit transfer is normally considered to be completed when the beneficiary's bank accepts the payment order.

6. Subparagraph (1)(d) places an obligation on the originator's bank for the timely completion of the credit transfer when no special instructions have been given to it by the originator by means of an execution or pay date. No standard is provided for determining what is an ordinary period of time, but it could be expected that in most situations an ordinary period of time would be determinable with reasonable objectivity.

Article 8. *Revocation and amendment of payment order*

(1) A revocation or amendment of a payment order issued to a receiving bank that is not the beneficiary's

Comments

1. Article 7 was not considered by the Working Group at its eighteenth session except that a portion of article

bank is effective if it is received in sufficient time for the receiving bank to act on it before the receiving bank has re-transmitted the order.

(2) A sender may require a receiving bank that is not the beneficiary's bank to revoke or amend the payment order the receiving bank has re-transmitted. A sender may also require a receiving bank to instruct the subsequent bank to which it re-transmitted the order to revoke or amend any order that the subsequent bank may in turn have re-transmitted.

(3) A revocation or amendment of a payment order issued to the beneficiary's bank is effective if it is received in time for the bank to act on it before the bank has accepted the order.

(4) A sender may revoke or amend a payment order after the time specified in paragraph (1) or (3) only if the receiving bank agrees.

(5) A sender who has effectively revoked a payment order is not obligated to reimburse the receiving bank [except for costs and fees] and, if the sender has already reimbursed the receiving bank for any part of the payment order, it is entitled to recover from the receiving bank the amount paid.

(6) Neither the death nor incapacity of either the sender or the originator affects the continuing legal validity of a payment order.

(7) The beneficiary's bank may reverse the credit entered to the beneficiary's account to the extent that the credit was in excess of the amount in the originator's payment order, was the result of a duplicate credit arising out of the same payment order by the originator or was entered to an account other than the account specified by the originator.

[(8) A bank has no obligation to release the funds received if ordered by a competent court not to do so [because of fraud or mistake in the funds transfer].]

#### *Comments*

1. Article 8 was not considered by the Working Group at its eighteenth session.

#### *Paragraphs (1) to (3)*

2. Paragraphs (1), (2) and (3) provide the basic rules for the revocation or amendment of a payment order. Under paragraph (1) the originator as a sender can revoke or amend its payment order until the originator's bank as a receiving bank has issued its own payment order intended to execute the originator's order. It may be noted that this will usually, but not always, be the same time the originator's bank has accepted the order under article 6(1). Since the originator's bank will need some period of time to act, the revocation or amendment is effective only if it is received in sufficient time for the bank to act on it before the bank's own payment order is issued.

3. If the originator's bank has already issued its own payment order, paragraph (2) provides that it can be instructed to issue its own revocation or amendment to its receiving bank. The effectiveness of that revocation or amendment is tested under paragraph (1). This series of messages can go from bank to bank until a payment order

is revoked or amended or the beneficiary's bank is reached. The credit transfer can no longer be interrupted by revocation or amendment of a payment order once the beneficiary's bank has accepted an order implementing the transfer.

#### *Paragraph (4)*

4. Even though the sender may no longer have the right to revoke a payment order under paragraph (1) or (3), the receiving bank may be willing to recognize the revocation or amendment, especially where it knows that it can recover any credit already granted to its credit party. In particular, the beneficiary's bank has the authority under paragraph (7) to reverse the credit under certain circumstances.

#### *Paragraph (6)*

5. Even though legal incapacity in international credit transfers is most likely to arise in connection with insolvency proceedings, the Working Group decided at its seventeenth session not to attempt to deal with that problem at that time (A/CN.9/317, para. 132).

#### *Paragraph (7)*

6. If the credit to the beneficiary's account is not in accord with the originator's payment order, one of the banks in the credit transfer chain has made an error or there has been fraud. Paragraphs (1) to (4) on revocation or amendment of the payment order are relevant if the error was made by a bank prior to the beneficiary's bank and was found prior to acceptance of the payment order by the beneficiary's bank. Paragraph (7) is relevant if the error was made by the beneficiary's bank or, if made by a prior bank, was found too late to revoke or amend the payment order prior to acceptance by the beneficiary's bank.

7. Paragraph (7) permits, but does not require, the beneficiary's bank to reverse the credit it has entered to the beneficiary's account. It goes beyond a provision that would give the beneficiary's bank a right of recovery that might have to be exercised in judicial proceedings if the beneficiary was not willing to allow the credit to be reversed. However, the right of reversal is available under paragraph (7) only if the credit to the account was objectively inconsistent with the originator's payment order.

#### *Paragraph (8)*

8. The Working Group decided to place paragraph (8) in square brackets pending a decision by the Commission whether it would undertake consideration of the problem in the context of stand-by letters of credit and guarantees (A/CN.9/317, para. 133).

## CHAPTER III. LIABILITY

### Article 9. *Liability of receiving bank*

(1) A receiving bank that fails in its obligations under article 5 is liable therefor to its sender and to the originator.

(2) The originator's bank and each intermediary bank that accepts a payment order is liable to its sender and to the originator for the losses as set out in paragraph (5) of this article caused by the non-execution or the improper execution of the credit transfer as instructed in the originator's payment order. The credit transfer is properly executed if a payment order consistent with the payment order issued by the originator is accepted by the beneficiary's bank within the time required by article 7.

(3) An intermediary bank is not liable under paragraph (2) if the payment order received by the beneficiary's bank was consistent with the payment order received by the intermediary bank and it executed the payment order received by it within the time required by article 7.

(4) The beneficiary's bank is liable

(a) to the beneficiary for its improper execution or its failure to execute a payment order it has accepted to the extent provided by the law governing the [account relationship] [relationship between the beneficiary and the bank], and

(b) to its sender and to the originator for any losses caused by the bank's failure to place the funds at the disposal of the beneficiary in accordance with the terms of a pay date, execution date or value date stated in the order, as provided in article 7.

(5) If a bank is liable under this article to the originator or to its sender, it is obliged to compensate for

(a) loss of interest,

(b) loss caused by a change in exchange rates,

(c) expenses incurred for a new payment order and for reasonable costs of legal representation,

(d) any other loss that may have occurred as a result, if the improper [or late] execution or failure to execute resulted from an act or omission of the bank done with the intent to cause such improper [or late] execution or failure to execute, or recklessly and with knowledge that such improper [or late] execution or failure to execute would probably result.

(6) Banks may vary the provisions of this article by agreement to the extent that it increases or reduces the liability of the receiving bank to another bank and to the extent that the act or omission would not be described by paragraph (5)(d). A bank may agree to increase its liability to an originator that is not a bank but may not reduce its liability to such an originator.

(7) The remedies provided in this article do not depend upon the existence of a pre-existing relationship between the parties, whether contractual or otherwise. These remedies shall be exclusive and no other remedy arising out of other doctrines of law shall be available.

## Comments

### Paragraph (1)

1. Paragraph (1) sets forth the liability of a receiving bank for its own failure to fulfil its own obligations under article 5.

### Paragraph (2)

2. The general system of liability in paragraph (2) is that the originator can hold the originator's bank liable for the proper performance of the credit transfer. This means that the bank would be responsible to the originator for loss wherever the loss occurred. In order to avoid liability the originator's bank would have to show that one of the exempting conditions in article 10 was relevant. If the loss for which the originator's bank is liable to the originator was caused by events that occurred at a subsequent bank in the credit transfer chain, the originator's bank can recover the loss from its receiving bank and each bank in turn could recover from its receiving bank until under paragraph (3) a bank could show that the payment order received by the beneficiary's bank was consistent with the payment order received by the bank in question.

3. This system of liability can be compared with the obligation of a receiving bank under article 5(3)(b) to refund to its sender any funds received from the sender where the credit transfer is not completed successfully.

4. It was decided at the seventeenth session of the Working Group that the originator should also be able to hold an intermediary bank liable for the losses suffered, since there may be occasions when recovery from the originator's bank may not be possible (A/CN.9/317, para. 139).

### Paragraph (3)

5. Paragraph (3) places a limit on the effect of paragraph (2) when the credit transfer is completed, but in a manner inconsistent with the originator's payment order. No bank that is subsequent to the error or fraud that caused the inconsistency has any liability for the fact that the credit transfer was carried out improperly. However, such a bank may have obligations under article 5(3)(b) or (c) to aid in correcting the situation.

### Paragraph (4)

6. The person who suffers loss as a result of a failure of the beneficiary's bank depends in large measure on the rules on completion of the transfer. Under the current text the transfer is complete when the beneficiary's bank accepts the payment order. Any obligations of the beneficiary's bank to make the funds available to the beneficiary are subsequent to the transfer. Under that view, subparagraph (4)(a) may be thought to fall outside the sphere of application of the Model Law. At the seventeenth session the Working Group decided to defer any decision to delete the subparagraph until it had a more complete view of the entire text (A/CN.9/317, para. 150). Compare article 5(4) and comment 17 to article 5.

7. Even though the transfer may normally be completed when the beneficiary's bank accepts the payment order received by it, the payment order may contain a pay date, execution date or value date. Especially when a pay date has been stated, but also when an execution or value date has been stated, the originator or the sender has indicated that the time when the beneficiary's bank is to act is important to it. If the beneficiary's bank fails in that



performance, the loss may be suffered by the originator or by the sender of the payment order, as well as by the beneficiary. Subparagraph (4)(b) provides for that case.

*Paragraph (5)*

8. In essence, paragraph (5) applies to losses caused by late or non-completion of a credit transfer. In this sense, timely completion of a transfer for less than the full amount may be considered to be a late transfer for the difference between the proper amount and the amount transferred in fact.

9. Losses arising out of unauthorized payment orders are allocated by article 4(2) and (3). The obligation of each receiving bank to refund to its sender any funds received from the sender where the transfer was not successfully completed is set forth in article 5(3)(b). A special rule applicable to the failure of a receiving bank to notify the sender that a misdirected payment order has been received is temporarily to be found in article 5(1 bis).

10. Interest losses may be suffered in several different ways as a result of a credit transfer that does not work as intended. The bank may have received funds from its sender and delayed execution of the payment order. In this case the sender (who may be either the originator or a sending bank) may be said to have suffered a loss of interest. If the result of the delay is that the entire credit transfer is delayed, the beneficiary could be said to have suffered the loss of interest. If the beneficiary can recover this loss of interest from the originator because of late payment of the underlying obligation, it would seem that the originator should be able to recover this amount from the originator's bank.

11. The second most likely form of loss arising out of delayed international credit transfers are exchange losses, as provided in subparagraph (5)(b).

12. The Working Group decided at its seventeenth session that, in exchange for a relatively strict regime of liability, the bank liable would not be responsible for indirect losses unless more stringent requirements were met than for the other elements of loss (A/CN.9/317, paras. 115 to 117). This decision was re-affirmed in another context at the eighteenth session of the Working Group (A/CN.9/318, paras. 146 to 150). The formula used in the current text was taken from article 8 of the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules). In order to recover the indirect losses, the claimant would have to prove the intent or the reckless behaviour of the bank.

13. One minor difficulty and another more important difficulty exist in the provision. The minor difficulty is that under the current wording the intent or reckless behaviour would seem to have to be that of the defendant bank rather than of "a" bank in the credit transfer chain. The more difficult problem is that, while a bank would be able to recover with relative ease from its receiving bank reimbursement for the amount of compensation it had been required to pay under subparagraphs (a) to (c) where the error, fraud or delay occurred at a subsequent point in the transfer chain, it may have more difficulty doing so

under subparagraph (d). In the recourse action its receiving bank may contest both the grounds of liability and the amount.

*Paragraph (6)*

14. Paragraph (6) provides an important rule setting forth the extent to which the provisions of this article can be varied by agreement of the parties.

*Paragraph (7)*

15. Paragraph (7), making the liability provisions of this article not dependent on a contractual relationship and making them exclusive, was added at the suggestion of the Working Group at its seventeenth session (A/CN.9/317, para. 119).

*Article 10. Exemption from liability*

A receiving bank and any bank to which the receiving bank is directly or indirectly liable under article 9 is exempt from liability for a failure to perform any of its obligations if the bank proves that the failure was due to the order of a court or to interruption of communication facilities or equipment failure, suspension of payments by another bank, war, emergency conditions or other circumstances that the bank could not reasonably be expected to have taken into account at the time of the funds transfer or if the bank proves that it could not reasonably have avoided the event or overcome it or its consequences.

*Comments*

1. Since the liability of a receiving bank for the interest loss, loss caused by a change in exchange rates and expenses incurred for a new payment order would arise out of the simple fact of failure of the transfer, article 10 provides the receiving bank with its sole basis of defence in such cases.

2. The bank must prove the exempting condition. Although there is a list of specific circumstances that might exempt the bank from liability, other circumstances not listed might also do so.

**CHAPTER IV. CIVIL CONSEQUENCES OF FUNDS TRANSFER**

*Article 11. Payment and discharge of monetary obligations; obligation of bank to account holder*

(1) Unless otherwise agreed by the parties, payment of a monetary obligation may be made by a credit transfer to an account of the beneficiary in a bank.

(2) The obligation of the debtor is discharged and the beneficiary's bank is indebted to the beneficiary to the extent of the payment order received by the beneficiary's bank when the payment order is accepted by the beneficiary's bank.

(3) If one or more intermediary banks have deducted charges from the amount of the credit transfer, the ob-

ligation is discharged by the amount of those charges in addition to the amount of the payment order as received by the beneficiary's bank. Unless otherwise agreed, the debtor is bound to compensate the creditor for the amount of those charges.

(4) To the extent that a receiving bank has a right of reimbursement from a sender by debit to an account held by the receiving bank for the sender, the account shall be deemed to be debited when the receiving bank accepts the payment order.

#### *Comments*

1. This article contains a number of important provisions that are associated with the credit transfer, though they do not have to do with the credit transfer itself. In many countries such provisions would not be included in a law governing funds transfers, while in others they would be included. They are included in this draft because it is important to keep them in mind even if it is decided at a later time to exclude some or all of this article from the final text of the Model Law. Furthermore, if any portion of this article is excluded from the final text, consideration might be given to preparing a separate text containing provisions on these issues so as to be sure that these rules would be consistent with the rules on the credit transfer itself.

#### *Paragraph (1)*

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

3. The Working Group agreed that paragraph (1) should be restricted to providing that an obligation could be discharged by a transfer without considering to what account the debtor-originator might have the funds sent (A/CN.9/317, para. 159).

#### *Paragraph (2)*

4. Paragraph (2) provides that the obligation of the debtor is discharged when the beneficiary's bank accepts the payment order. At the same time the beneficiary's bank becomes indebted to the beneficiary. The use of acceptance of the payment order as the relevant point of time is consistent with articles 7(1)(c) and (d) and 8(3).

5. In the Working Group it was pointed out that in some countries an obligation was considered to be discharged when the originator's bank received the payment order with cover from the debtor-originator. It was thought that other countries might provide that the discharge would be later in time than as provided in paragraph (2). Therefore, the Working Group decided to consider at a future session what effect such national laws on discharge of the underlying obligation should have on the appropriate rules on

finality of the credit transfer, keeping in mind its position that the rules on discharge, whether under the Model Law or under national law, and the rules governing finality should be consistent (A/CN.9/317, paras. 160-162).

#### *Paragraph (3)*

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

#### *Paragraph (4)*

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

## CHAPTER V. CONFLICT OF LAWS

### Article 12. *Conflict of laws*

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

(2) In the absence of agreement to the contrary, the law of the State where an obligation is to be discharged governs the mutual rights and obligations of an origina-

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

#### Comments

1. The Working Group at its seventeenth session requested the secretariat to prepare a draft provision on

conflict of laws (A/CN.9/317, para. 165). The draft provision set out above was prepared for the eighteenth session of the Working Group, but it was not considered at that session.

2. The problem of conflict of laws is considered in more detail in the accompanying report of the Secretary-General, A/CN.9/WG.IV/WP.42, especially in light of the decisions of the Working Group at its eighteenth session that the text under preparation should be in the form of a model law for adoption by national legislative bodies and that it should be restricted to international credit transfers.

### C. International credit transfers: major issues in the Model Law on International Credit Transfers: report of the Secretary-General<sup>a</sup> (A/CN.9/WG.IV/WP.42) [Original: English]

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1. The discussion at the eighteenth session of the Working Group indicated general satisfaction with the overall structure of the draft Model Law on International Credit Transfers as it appears in the annex to the report of that session of the Working Group (A/CN.9/318). The discussion at the eighteenth session also showed that there were certain major issues that did not lend themselves to proper solution by an article-by-article analysis. This report is intended to give the basis for a discussion of those issues in a more comprehensive manner.

#### I. ACCEPTANCE

2. The strongest controversy in the Working Group has been whether the concept of acceptance of a payment order by the receiving bank should be retained in the Model Law. Use of the concept has been advocated as a convenient means to describe in a single word a number of different actions of different receiving banks that should have the same legal consequences, making it possible to use the word in various substantive provisions. In response, it has been said that use of the term "acceptance" is not necessary and that it would cause difficulties in many legal systems because it seems to suggest that a

<sup>a</sup>Working paper submitted to the Working Group on International Payments at its nineteenth session.

contract is created as a result of the receiving bank's actions.

3. Although the controversy in the Working Group as to the use of the concept of acceptance has been strong, it does not appear to represent a conflict about the substantive rights and obligations of the parties to the credit transfer. On the contrary it appears to represent only a matter of approach to the drafting of appropriate solutions to the underlying problems.

4. The decision whether the concept of acceptance should be retained in the Model Law depends upon whether it is the most efficient way to express the desired legal results. That in turn involves a discussion of both the criteria for determining when a receiving bank has accepted a payment order and the consequences of acceptance. At the current stage of the development of the Model Law, where the very use of the concept is not settled, it is not surprising that neither the criteria nor the consequences of acceptance are agreed upon and that the text of the draft Model Law as it appears in the annex to A/CN.9/318 is not completely consistent.

5. The substantive issues that are resolved in the current draft by use of the concept of acceptance are of vital importance. Most of them have not as yet been discussed by the Working Group in depth. Therefore, even though the final decision on the substance of those issues should be separated from the question whether they should be resolved by use of the concept of acceptance, both questions will be treated in this report.

6. Under the current text the acceptance of a payment order by the receiving bank has the following consequences:

- (a) The receiving bank undertakes certain obligations to execute the payment order or to aid in overcoming problems that have arisen in its execution;
- (b) The sender becomes obligated to pay the receiving bank for the payment order and, if the receiving bank has a right of reimbursement from the sender by debit to an account held by the receiving bank for the sender, the account is deemed to be debited;
- (c) When the receiving bank is the beneficiary's bank, the right of the sender to revoke a payment order issued to it is terminated;
- (d) When the receiving bank is the beneficiary's bank, the beneficiary's bank becomes indebted to the beneficiary and the obligation of the originator to the beneficiary is discharged.

#### A. Obligations of the receiving bank

##### 1. Obligations of notification—no acceptance necessary

7. The only obligations imposed by the draft Model Law on a bank that receives a payment order are certain obligations of notification of problems. Those obligations of notification arise independently of any acceptance of the

payment order by the receiving bank; indeed, they assume that the payment order has not been accepted. The obligations of notification imposed by the draft Model Law are as follows:

- (a) A receiving bank must notify the sender of a discrepancy in the amount of the payment order as described in words and in figures. That obligation may be negated by agreement between the sender and the receiving bank (article 3(1));
- (b) The beneficiary's bank must notify the sender and the originator's bank, if the originator's bank is identified on the payment order, of a discrepancy in the identification of the beneficiary as described in words and in figures (article 3(2));
- (c) In the absence of an agreement otherwise, a receiving bank that decides not to comply with a payment order must notify the sender, unless one of the reasons for the decision is insufficient funds (article 5(1));
- (d) A receiving bank must notify the sender when a payment order is received that contains information indicating that it has been misdirected (article 5(1 bis)).

#### 2. Obligation to execute the payment order

##### (a) Existence of the obligation

8. Under article 5(1) of the draft Model Law an obligation to take actions intended to execute a payment order arises only if the receiving bank accepts the payment order. In some cases banks agree with specific senders or in an interbank agreement, such as a clearing-house arrangement, to execute payment orders received from those senders. Even in those cases, however, the obligation remains only contractual until each specific payment order is accepted, when an additional obligation under the Model Law is undertaken. Nevertheless, it should be noted that, according to article 9(7), the remedies available for breach of the contractual obligation are limited to those available under the Model Law.

9. An obligation to take actions intended to execute a payment order, as distinguished from an obligation to execute the order properly, is an obligation to take action in the future. Such an obligation does not normally arise under the draft Model Law in the case of a receiving bank that is not the beneficiary's bank since the most common means of acceptance is by sending a payment order intended to carry out the payment order received (article 6(1)(a)). Under article 5(4) the beneficiary's bank always undertakes obligations to take action in the future but, unless the payment order contains an execution date or a pay date, those obligations run only to the beneficiary and are subsequent to the completion of the credit transfer.

10. Article 4(4), which governs the duties of the sender to pay the receiving bank, provides for one case in which a receiving bank may undertake a duty to execute a payment order in the future. It anticipates that a receiving bank may accept an order on day one with an execution date of day five or may accept an order that provides for a number of payments to be made at various dates in the future. Such a receiving bank may be any bank in the

credit transfer chain, but it is most likely to be the originator's bank.

11. The current draft has no provision indicating how the receiving bank would accept the order prior to its execution date. Presumably, it would do so by an overt act, such as notification to the credit party of its receipt of, and of its intention to execute, the order. (The bank could also accept the order by executing it prior to the execution date. See A/CN.9/WG.IV/WP.41, comment 14 to article 4. However, that possibility is not relevant to this discussion since the bank would have no remaining obligation to execute the payment order in the future.) When a receiving bank has accepted an order in those circumstances, it can no longer reject the order for any reason, including insufficient funds. It may be noted that the sender would lose its right to revoke or amend the payment order if the receiving bank was the beneficiary's bank (article 8(3)), but not in the case of other receiving banks (article 8(1)). See paragraph 27, below.

12. An obligation to take action intended to execute the payment order can also arise when the payment order calls for current execution if the receiving bank fails to act within a prescribed period of time. According to article 6(1)(b), a receiving bank other than the beneficiary's bank accepts a payment order if it does not give a notice required by article 5(1) that it will not comply with the order. Since there has been acceptance of the order but no execution of it, the bank has an obligation to act, an obligation it is unlikely to carry out but which gives a basis for the remedies available to the originator or the sender. No similar provision exists in the current text of article 6(2) in regard to the beneficiary's bank.

*(b) Evaluation of the use of acceptance*

13. It is difficult to avoid use of the concept of acceptance or its equivalent in respect of article 4(4) if the assumption of that article is maintained, i.e. that a bank can accept a payment order after its receipt and prior to its execution date for execution on the execution date. While the obligation to execute the order on the execution date could be considered to be merely contractual, as is the case for the obligation arising out of an agreement to comply with payment orders to be received in the future, it seems more appropriate for it to be a legal obligation based on the Model Law. This is particularly true since it is not clear that all legal systems would find the necessary elements of contract in the situation.

14. The use of the concept of acceptance is perhaps unnecessary when the obligation to execute the order arises out of a failure to give a required notice in regard to a payment order that was intended for immediate execution. In most cases execution would never occur, and the liability of the receiving bank could be based on the failure to give the notice required by article 5(1) rather than on a failure to execute the payment order. In the rare case where execution would occur, though late, the liability regime could be drafted to give the proper result without referring to acceptance. However, the use of the concept of acceptance in these cases leads to proper results.

15. Since acceptance by the beneficiary's bank essentially marks the completion of the funds transfer, the advisability of retaining the concept in respect of the beneficiary's bank is discussed in that context in paragraphs 28 to 42, below.

16. It should be noted that the current text of article 5 of the Model Law does not specifically state that a receiving bank that accepts a payment order must execute that order. Instead, it sets forth specific obligations of the receiving bank that would lead to proper execution of the payment order.

*3. Obligation to execute properly*

17. A receiving bank that accepts a payment order is obligated by article 5 not only to take actions intended to comply with the payment order received, but also to take actions that in fact comply with the order. In the case of a receiving bank other than the beneficiary's bank, the obligation under article 5(3) is to issue a proper payment order to a proper bank within a proper period of time. Furthermore, under article 9(2) it is liable to its sender and to the originator for the losses caused by the non-execution or improper execution of the originator's payment order, with right of reimbursement from its receiving bank unless it was itself the bank where the non-execution or improper execution originated. In the case of the beneficiary's bank, its obligation is to make the funds available to the beneficiary in the manner specified in article 5(4).

18. It is not necessary to use the concept of acceptance in this context. Article 5(3)(a) and article 9(2) could be restated to say that a receiving bank other than the beneficiary's bank that undertakes to execute a payment order must take certain actions and would be liable for certain consequences. However, the drafting of the provisions would be more complicated. In respect of the beneficiary's bank, the advisability of retaining the concept of acceptance is discussed in the context of completion of the credit transfer in paragraphs 28 to 42, below.

*4. Assistance in correcting problems*

*(a) Receiving bank other than beneficiary's bank*

19. Whether or not the receiving bank executes the order received, it may turn out that the transfer is not completed successfully. When the transfer is a failure, a receiving bank other than the beneficiary's bank is obligated, according to article 5(3)(b), to refund to its sender any funds it has received. Article 5(3)(c) sets forth an obligation of the receiving bank to assist in completing the transfer for the correct amount when the transfer was for too small an amount.

20. In general, it is not necessary to use the concept of acceptance for these two situations. The obligation could be said to be that of a receiving bank other than the beneficiary's bank that has issued a payment order intended to execute the order received, without referring to acceptance of the order received.

21. The use of the concept of acceptance or its equivalent would be necessary when the receiving bank has undertaken an obligation to act in the future, especially as anticipated in article 4(4), but has not issued its own payment order as required. While the failure of the bank to fulfil its obligation to carry out the payment order it has accepted is the same as described in paragraphs 11 to 13, above, the failure gives rise to damages under article 9, and to an obligation to aid in correcting the problem under article 5(3)(b) and (c).

22. In article 5(3)(b) the circumstances that constitute a failure of the transfer are currently described in terms of a proper payment order not having been "issued to or accepted by the beneficiary's bank". Other wording could undoubtedly be found, but the provision would probably be more complicated in its presentation.

*(b) Beneficiary's bank*

23. According to article 8(7) the beneficiary's bank has the right to reverse a credit to the beneficiary's account in certain cases of error, but is not required to do so. The right of reversal of the credit is set forth without reference to whether the beneficiary's bank had accepted the payment order received, although it would in fact have done so under article 6(2).

**B. Payment of the order by the sender**

24. According to article 4(4)

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

25. The sender's obligation to pay the receiving bank arises at the same time that the receiving bank undertakes obligations in respect of the payment order, since one obligation is the counterpart of the other. Without use of the concept of acceptance, it would be awkward to draft a provision that was equally applicable to receiving banks that were and receiving banks that were not the beneficiary's bank and to receiving banks that undertook an obligation to execute the order in the future and those that executed the order on, before or after the execution date. However, it does not seem appropriate that the sender is obligated to pay the receiving bank when acceptance has occurred through the failure of the receiving bank to give a notice required under article 5(1) that it would not comply with the payment order.

26. When payment is to be made by debit to an account held by the receiving bank for the sender, article 11(4) provides that the account is deemed to be debited when the receiving bank accepts the payment order, even if no entry has as yet been made to the account. This provision is but a special application of article 4(4). It will have its most important effect when there is legal process against the sender's account, e.g. attachment of the account or sequestration of the funds, or insolvency proceedings have commenced against the sender.

**C. Revocation or amendment of payment order**

27. The concept of acceptance is not used in respect of the time until which a sender can revoke or amend a payment order sent to a receiving bank other than the beneficiary's bank. Instead, article 8(1) provides that the revocation or amendment is effective "if it is received in sufficient time for the receiving bank to act on it before the receiving bank has re-transmitted the order". If the payment order had a future execution date, the revocation or amendment would be effective until the order was executed even if the revocation or amendment was received after the receiving bank had accepted the order, a situation anticipated in article 4(4).

**D. Completion of the credit transfer**

*1. Consequences of completion*

28. The Model Law provides that when the payment order is accepted by the beneficiary's bank,

(a) the payment, and therefore the transfer, can no longer be revoked or amended (article 8(3));

(b) the beneficiary's bank is indebted to the beneficiary (article 11(2));

(c) the obligation of the originator to the beneficiary is discharged (article 11(2));

(d) the beneficiary's bank undertakes certain obligations to make the funds available to the beneficiary (article 5(4) and 7(1)(c));

(e) a determination can be made whether the credit transfer was executed within the proper time (articles 9(2), 7(1)(c) and (d)).

Taken together, these consequences of acceptance may be considered to constitute completion of the credit transfer.

29. By this set of provisions any given credit transfer would be completed for almost all purposes at a single point of time, i.e. when the beneficiary's bank accepts the payment order. Actions and obligations of the beneficiary's bank subsequent to acceptance would, with few exceptions, be of relevance only to the beneficiary.

30. The same result could be achieved by using a different word in the Model Law, such as "completed" or "final". However, the use of such a word in the text of the Model Law might create its own difficulties since it might imply that the beneficiary's bank had no further obligations under the Model Law or other applicable law to take actions as a result of the transfer. Furthermore, in many cases there would not have been full and final settlement between all of the banks in the credit transfer chain. Therefore, use of the concept of acceptance in the text of the Model Law may seem to be the more advisable solution.

31. In respect of discharge of the underlying obligation, the view has been expressed in the Working Group that no rule should be included in the Model Law because such a rule properly belongs in a legal text relating to the dis-

charge of monetary obligations and not in a legal text on credit transfers. Moreover, although the point has not yet been discussed in depth, it has been suggested that the time of discharge—whether set out in the Model Law or in a separate text—might appropriately be at a different time from that when the credit transfer was completed. It has also been suggested that the approach of the current draft of the Model Law is correct; the time of discharge of an obligation should be set forth in the Model Law and, even if set forth in a separate text, discharge should take place at the same time as the other aspects of completion of the credit transfer occur.

## 2. *Criteria for completion/acceptance*

32. Although the draft Model Law provides that the five consequences set out in paragraph 28 would occur when a payment order was accepted by the beneficiary's bank, article 6(2) provides that different payment orders would be accepted at different points of time. When a given payment order would be accepted would depend on various factors in the relationship between the sender and the beneficiary's bank and on the means by which the beneficiary's bank processes the payment order and the resulting credit to the beneficiary's account.

33. It would be possible for there to be a single event or point of time when all beneficiary's banks would be considered to have accepted all payment orders received. Any of the points of time indicated in Chapter IV of the UNCITRAL Legal Guide on Electronic Funds Transfers<sup>1</sup> might be used. However, the use of a single event or point of time to govern all credit transfers and all beneficiary's banks would work best if all beneficiary's banks processed all payment orders in the same way and in the same sequence. That may be the case in some countries; it is not the case in others and it is certainly not on a world-wide scale. Therefore, in order to have a clear rule that could be applied in many different situations, an event that was both objective and universal in its significance would have to be chosen.

34. Receipt of the payment order by the beneficiary's bank would meet those criteria, but would be too early in most cases. Credit to the beneficiary's account with no right to reverse the credit except for correction of error under article 8(7) would be a significant event, but it is often difficult to determine when that event occurs in an electronic environment. Moreover, in many situations the time when the account is credited is determined by the administrative convenience of the bank rather than by considerations related to the consequences of acceptance noted above. The latest event that might be chosen would be giving the beneficiary notice that the credit was available for use.

35. It could be considered to be undesirable for the consequences of completion of an international credit transfer for credit to the beneficiary's account to take place at as late a point of time as the giving of notice to

the beneficiary. In almost every credit transfer involving credit to the beneficiary's account, the beneficiary's bank is chosen by the beneficiary. Errors or delays in crediting the beneficiary's account should be at the risk of the beneficiary and not at the risk of either the originator or any of the banks prior to the beneficiary's bank. It is particularly pertinent that a delay in credit to an account or notification of the credit to the beneficiary may be the result of banking practices in the State where the beneficiary's bank is located or of an agreement between the beneficiary and its bank, practices or agreement that may be completely unknown to either the originator or to the banks prior to the beneficiary's bank. This analysis suggests that the transfer should be considered to be completed at the earliest possible time.

36. If this analysis is accepted, further consideration might be given to the relatively rare cases where the beneficiary does not have an account at the beneficiary's bank.

37. The current draft of subparagraph (a) of article 6(2) implements the policy of early completion of the transfer. If the sender and the beneficiary's bank have agreed that the bank will execute payment orders received from the sender without notification that cover is in place, the beneficiary's bank is considered to have accepted the payment order as soon as the order is received. That rule would be applicable to the London Clearing House Automated Payment System (CHAPS), but not to the New York Clearing House Interbank Payments System (CHIPS). Subparagraph (a) may be contrasted with the rule governing a receiving bank that was not the beneficiary's bank. According to article 5(1) such a bank would be contractually obligated to execute the payment order but it would not have the obligations of a bank that had accepted the payment order until it sent its own payment order intended to carry out the payment order received.

38. Subparagraph (b) of the draft of article 6(2) presented to the Working Group at its eighteenth session in A/CN.9/WG.IV/WP.39 also implemented the policy that the beneficiary's bank should be considered to have accepted the payment order at the earliest possible point of time. Subparagraph (b) provided that acceptance took place

“when the bank receives both the payment order and notice that cover is available, provided that there was a prior relationship with the sender”.

39. Those two provisions also reflected the judgment that there was only one valid reason for the beneficiary's bank to fail to comply with a payment order that was complete and correct on its face, namely that the bank had not as yet received reimbursement from the sender. Subparagraph (b) did not face the question of the extent to which a receiving bank should be expected to accept payment by credit in its account with the sender or in its account with a third bank.

40. Other reasons for failing to comply that have been suggested in regard to originator's banks or intermediary banks, such as suspected laundering of money received from illegal sales of narcotic drugs, seem to be less

<sup>1</sup>A/CN.9/SER.B/1, United Nations publication Sales No. E.87.V.9

applicable to a beneficiary's bank where credit is to be entered to the beneficiary's account. It would be unlikely that the bank could be sufficiently suspicious of an individual transfer for it to reject a payment order unless there had been a prior pattern of suspicious transfers. In that case, the bank could be expected to close the account or report its suspicions to the proper authorities rather than to reject the payment order.

41. The Working Group at its eighteenth session rejected the approach of the draft text in A/CN.9/WG.IV/WP.39 by deleting article 6(2)(b) and deciding that a volitional element should be added to article 6(2)(a), although it did not add that element to the text due to a lack of time (A/CN.9/318, para. 137). It stated that the beneficiary's bank might have reasons to reject a payment order received in addition to the non-receipt of payment for the order. It was suggested that the beneficiary might have instructed the bank not to accept the particular payment order or not to accept a particular category of payment orders. In addition, the beneficiary's bank should not be held to have accepted a payment order that is so incomplete or incorrect that it cannot or should not be implemented. Compare the situation of the receiving bank under article 4(2) if the authentication of the order appears to be improper. It would seem, however, that those particular problems could be accommodated in a general rule of early completion of the transfer. In any case, the Working Group has not as yet formulated an alternative policy as to when the beneficiary's bank should be considered to have accepted the payment order, or, alternatively, when the credit transfer should be considered to be completed.

42. Subparagraphs (c), (d) and (e) constitute three different volitional acts that might be performed by a beneficiary's bank in a given transfer that might be considered to be acceptance of the payment order, thereby bringing it to completion. They would apply to those situations where the beneficiary's bank executed the payment order before payment was provided under either subparagraph (a) or the now deleted subparagraph (b).

## II. EFFECT OF BANK INSOLVENCY ON THE CREDIT TRANSFER

43. The insolvency of a bank can affect the credit transfer in a number of different ways. The current text of the draft Model Law has no provisions that were intended to deal with that problem. However, existing provisions provide solutions for some of the situations.

44. Article 5(3)(b) provides that where the beneficiary's bank does not accept a payment order consistent with the contents of the payment order issued by the originator, each receiving bank must refund to its sender any funds received from the sender. This provision was drafted with the case in mind of the payment order that designates an incorrect beneficiary's bank or an incorrect beneficiary or that is delayed at some point and is never completed. The originator and all receiving banks are expected to be restored to their original position. If the funds cannot be recovered from the incorrect beneficiary or the bank that

holds them, the loss should be suffered by the bank that made the error. However, it appears that article 5(3)(b) might place the loss on a bank that sent the order to an insolvent bank or beneficiary since its obligation to refund would exist whether or not it received a refund from the insolvent bank or beneficiary. That result was anticipated by the Working Group at its eighteenth session, A/CN.9/318, para. 153. See also, A/CN.9/WG.IV/WP.41, comment 14 to article 5.

45. Article 5(3)(b) would also apply to the case where the credit transfer failed because an intermediary bank that had received payment from its sending bank ceased payments before executing the order received. As above, article 5(3)(b) would place the risk of non-reimbursement on the bank that sent the order to the failed intermediary bank. This may be thought to be an appropriate solution, except in the case where the originator or a prior sending bank designated the use of the failed intermediary bank. It may be thought that in such a case the credit risk should fall upon the originator or the bank that designated the use of the intermediary bank that failed.

46. A somewhat different problem arises if a receiving bank has executed the payment order and its sender is unable to pay the receiving bank for it. The current text of the draft Model Law has no rule where the receiving bank is the beneficiary's bank. Whether the beneficiary's bank would have a right to reverse the credit to the beneficiary's account would probably be governed by the law of the State where the beneficiary's bank was located. See paragraphs 69 to 80, below. When the receiving bank was not the beneficiary's bank, under article 4(4) it would be bound on its own order as a sender and would suffer the loss. This result is clearly appropriate when the sender is the originator.

47. The appropriateness of the result is less clear when the sender is a bank. Although it contributes to financial prudence on the part of receiving banks, it does so by encouraging receiving banks to delay the execution of payment orders they receive until they have received payment from their senders. That reduces the operational efficiency of the receiving banks individually and has serious effects on the operational efficiency of the funds transfer system as a whole. It slows the flow of money through the system and it makes it impossible for originators or their banks to plan the amount of time necessary for a credit transfer to be carried out if the transfer must pass through at least one intermediary bank or through a clearing house.

48. Different practices have arisen to counteract this latter problem. Two of particular importance to international credit transfers are the practices followed by CHAPS in London and CHIPS in New York.

— Under the CHAPS rules, the receiving bank is required to give same day credit to its credit party. This obligation remains even if there is a failure of one of the settlement banks to settle its balances at the end of the day. Such a rule protects the efficiency of the payment system. Financial prudence is guaranteed by various administrative and regulatory procedures outside the



payment system itself. While these procedures assure all parties that no receiving bank will suffer loss if a sending bank fails to settle its net debit balance, they depend upon the particular organization of the banking system in the United Kingdom and the expectation that the Bank of England will guarantee the settlement.

— Under the CHIPS rules, the failure of a participating bank to settle its net debit balance at the end of the day can result in the withdrawal from the settlement of all transfers to and from that bank made during the day. Although the procedure has never been resorted to, the possibility means that receiving banks are not required to give credit to their credit parties until after final settlement at the end of the day. Nevertheless, in order to accommodate their customers and to increase the efficiency of the payment system, receiving banks often execute payment orders when they are received and prior to settlement. However, the practice has been to grant credit to the credit party on a provisional basis subject to the bank receiving settlement, and that practice has been assumed to be legally permissible even though there is no directly relevant authority. As a result, there has been the continuing possibility that the entire day's settlement for transactions made through CHIPS would be reversed.

49. The problems posed by the CHIPS rules and the dangers they present for the payment system as a whole have received a great deal of attention in the United States and various steps have been taken to reduce those problems. Of direct interest to the Model Law are new provisions that have been inserted into the February 1989 version of the proposed new article 4A of the Uniform Commercial Code. The provisions seem to be of sufficient general interest to discuss them at length.

50. Draft section 4A-207(1) provides that when a receiving bank other than the beneficiary's bank executes a payment order it has received, it accepts the order, thereby becoming bound by it. Such a receiving bank takes the credit risk if it has not already received payment for the order it received.

51. If the receiving bank is the beneficiary's bank, the solution is somewhat more nuanced. Draft section 4A-207(2)(a) provides that the beneficiary's bank accepts a payment order, thereby becoming bound by it,

"at the time the bank . . . (ii) notifies the beneficiary of receipt of the order or that the account of the beneficiary has been credited with respect to the order *unless the notice indicates that the bank is rejecting the order or that funds may not be withdrawn until receipt of payment from the sender of the order.*" (Emphasis supplied.)

52. Draft section 4A-207(2)(a) will no longer permit banks to follow their current practice of granting withdrawable credit that nevertheless remains provisional until receipt of settlement. While that provision will be applicable to any situation where the beneficiary's bank has not as yet received payment for the payment order received, it will be of greatest significance in the context of a net settlement arrangement, of which CHIPS is by far the most important in the American credit transfer context.

53. Those two provisions of draft section 4A-207 standing by themselves would discourage receiving banks from making funds available to the beneficiary or other credit party prior to settlement. That would be considered to be undesirable, since it would reduce the efficiency of the payment system.

54. The problem is overcome by paragraphs (1) to (3) of draft section 4A-403, which are, because of their importance, set out in full.

"(1) Payment of the sender's obligation under Section 4A-402 [similar to article 4(4)] to pay the receiving bank occurs at the earliest of the following times:

"(a) If the sender is a bank, payment occurs when the receiving bank receives final settlement of the obligation through the Federal Reserve System or through a funds transfer system.

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

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

"(2) If the sender and receiving bank are members of a funds transfer system that nets obligations multilaterally among participants, the receiving bank receives final settlement when settlement is complete in accordance with the rules of the system. The obligation of the sender to pay the amount of a payment order transmitted through the funds transfer system may, to the extent permitted by the rules of the system, be satisfied by setting off and applying against the sender's obligation the right of the sender to receive payment from the receiving bank of the amount of any other payment order transmitted to the sender by the receiving bank through the funds transfer system. The aggregate balance of obligations owed by each sender to each receiving bank in the funds transfer system may, to the extent permitted by the rules of the system, be satisfied by setting off and applying against such balance the aggregate balance of obligations owed to the sender by other members of the system. The aggregate balance shall be determined after the right of setoff stated in the second sentence of this subsection has been exercised.

"(3) If two banks transmit payment orders to each other under an agreement that settlement of the obligations of each bank to the other under Section 4A-402 [similar to article 4(4)] shall be made at the end of the day or other period, the total amount owed with respect to all orders transmitted by one bank shall be set off against the total amount owed with respect to all orders transmitted by the other bank. To the extent of the setoff each bank has made payment to the other. If the setoff does not result in full payment of the total amount owed with respect

to all orders transmitted by one of the banks, the amount of the setoff shall be applied to the various orders transmitted by that bank in proportion to the amounts of the orders. If, after the setoff, the net amount owing by the bank is paid, that amount shall be similarly applied to the orders transmitted by the bank."

55. As a result of those provisions, a receiving bank incurs no greater credit risk prior to settlement than its net credit balance with the particular sending bank, whether that balance has arisen from direct bilateral netting or, to the extent permitted by the rules of the system, from multilateral netting arrangements.

56. The new draft provision appears to be inspired by the conclusions of the report issued by the Bank for International Settlements in February 1989 "Report on Netting Schemes". While the report was drafted with particular regard to foreign exchange contracts, it states that its conclusions are also applicable to payment netting arrangements.

57. The Working Group may wish to consider whether the Model Law should contain provisions directed towards the consequences of the failure of a sender, including a sending bank, to pay the receiving bank. If it does, it may wish to consider whether a provision should be prepared for inclusion in the Model Law based upon the solutions contained in the proposed section 4A-403 of the Uniform Commercial Code.

### III. EFFECT OF MODEL LAW ON ACCOUNT RELATIONSHIP

58. The mandate of the Commission to the Working Group was to prepare a text that would govern a credit transfer from customer to customer. Various delegates to the Working Group have insisted that the most important aspect of the preparation of the Model Law was to establish the rights and obligations of the customers in a credit transfer, since it could be assumed that banks could regulate most of the questions that would arise between themselves on the basis of interbank agreements.

59. A funds transfer, whether by means of a credit transfer or of a debit transfer, results in a debit to the account of the transferor of the funds and a credit to the account of the transferee of the funds. Therefore, a law that governs the complete transfer from bank customer to bank customer must have some provisions specifying the right of the originator's bank to debit the originator's account, the obligation of the beneficiary's bank to credit the beneficiary's account and the consequences of the entering of the debits and credits by the banks. By including such provisions, the law will affect the rights and obligations of those customers and their banks in respect of the account relationship.

60. This would not create difficult problems if the Model Law was being prepared for adoption by a particular State,

since the drafters could take account of the existing law governing the account relationship. If the new law on credit transfers required changes in the law governing account relationships, the appropriate provisions could be included either in the text of the new law or as amendments to any other law in that State governing the account relationship.

61. The Model Law must be prepared in the expectation that the States in which it will be adopted will have a wide range of legal rules in respect of the account relationship. It may be desirable, therefore, for the Model Law to have as little effect on the account relationship as would be compatible with the mandate to prepare rules that govern the transfer from customer to customer. Nevertheless, since the text under preparation is in the form of a model law and not of a convention, it may be permitted to include provisions that are thought to be appropriate from a substantive point of view, even if they might be thought to go beyond the limits of what some States would include in a law on credit transfers or they might be in conflict with legal rules on the account relationship in some States.

62. The account relationships that are affected by a credit transfer are not only those of the originator in the originator's bank and the account of the beneficiary in the beneficiary's bank, but also the accounts that banks have with one another that are used to pay for payment orders sent between them.

63. The originator's account is affected by articles 4(4) and 11(4) governing a sender's obligation to pay for a payment order it has sent. In the current text of article 4(4), a sender becomes obligated to pay the receiving bank for the payment order when the receiving bank accepts it. According to article 11(4)

"To the extent that a receiving bank has a right of reimbursement from a sender by debit to an account held by the receiving bank for the sender, the account shall be deemed to be debited when the receiving bank accepts the payment order."

64. Article 11(4) is apt to have its greatest importance when the sender becomes insolvent or there is legal process against the sender's account prior to the entry of the debit to the sender's account. It assumes that debiting the account of the sender has the legal effect of reducing the amount owed by the bank to its customer or increasing the amount owed by the customer to the bank. It is not, however, so stated in the provision or elsewhere in the draft Model Law. The effect of the provision would be that the book-keeping entry would not have to be made to achieve that result. To this degree article 11(4) enters into the law governing the account relationship between the originator and the originator's bank.

65. However, article 11(4) is unlikely to be applied very often in respect of the account of an originator since banks seldom act on the instructions of a customer prior to debiting the customer's account. Article 11(4) could be expected to be more often applied to the account of a sending bank that is being serviced by the receiving bank, since it is reasonable to believe that banks are more apt to execute a payment order they have received from another

bank before debiting the sending bank's account than to execute a payment order received from a non-bank customer prior to debiting the sender's account.

66. The extent to which the Model Law must enter into the account relationship between the beneficiary and the beneficiary's bank depends in large measure on the events marking completion of the credit transfer, i.e. acceptance of the payment order by the beneficiary's bank. If the credit transfer is considered to be completed and any obligation of the originator to the beneficiary is discharged at an early point of time after receipt of the payment order by the beneficiary's bank, such as is suggested in paragraphs 37 and 38, above, the crediting of the funds to the beneficiary's account or the making of the funds available to the beneficiary need not be considered in the Model Law. The single exception would be those cases when the payment order contained a payment date or an execution date, since the originator or the sender has directed that action be taken by a certain time and has an interest that it be done by that time.

67. If the credit transfer is to be considered completed only upon a volitional act of the beneficiary's bank in respect of the beneficiary or its account, consideration would have to be given as to whether the Model Law should include standards as to when and how the beneficiary's bank would have to act, since the originator would have a legitimate interest in prompt action by the bank.

68. The current text of the draft Model Law sets out in article 7 the time within which a beneficiary's bank, as a receiving bank, must act. Beneficiary's banks are specially mentioned in article 7(1)(c) and (d). The actions required of a beneficiary's bank that has accepted a payment order are set out in article 5(4).

#### IV. CONFLICT OF LAWS

69. At its seventeenth session the Working Group requested the Secretariat to prepare a provision on conflict of laws in respect of credit transfers (A/CN.9/317, para. 165). A provision was prepared for the eighteenth session of the Working Group as article 12 of the draft Model Law presented in A/CN.9/WG.IV/WP.39. The Working Group did not consider article 12 at its eighteenth session, and it remains unchanged in the text before this session of the Working Group.

70. The purpose of the Model Law is to provide a means of unifying the basic legal principles and rules governing international credit transfers. To the extent the Model Law is eventually adopted by individual States, problems of conflict of laws are reduced. However, not all States will adopt the Model Law or adopt it in its pure form and the Model Law is unlikely to cover all conceivable issues.

71. The first problem to be considered is the territorial application of the Law. In addition, consideration may be given to a provision governing the conflict of laws where the dispute arises in a State that has adopted the Model Law but the other State or States concerned have not, or

where the text of the Model Law does not govern the issue at hand.

72. Problems in respect of the territorial application of the Model Law are illustrated by article 1(1) on its substantive sphere of application. Under that article the Model Law does not apply to the transfer unless there are at least two banks in different States and each of those two banks has a customer. It does not matter whether the customer of either or both of the banks is itself a bank. As a result, for the Model Law to apply under article 1(1) at least two payment orders must be issued, from originator to originator's bank and from originator's bank to beneficiary's bank. See discussion in A/CN.9/WG.IV/WP.41, comments 1 to 8 on article 1.

73. The requirement that there be a minimum of two payment orders for the credit transfer to come within the sphere of application of the Model Law emphasizes the dual nature of the relationships involved in the transfer and of the law governing those relationships. The transfer consists first of all of a series of bilateral relationships between a sender (originator or sending bank) and a receiving bank, and many of the provisions of the Model Law govern that relationship. The transfer itself is, however, defined as the "complete movement of funds from the originator to the beneficiary", and a certain number of provisions consider the relationships from that point of view.

74. While it would be desirable for a single law to govern the entire credit transfer so that the rights and obligations of all of the parties to the transfer would be consistent, that result cannot be achieved by application of rules of conflict of laws, including a provision on the territorial application of the Model Law. Some of the rules in any legal system have operational significance for the banks, such as the existence or extent of any obligation of a receiving bank to react to a payment order received or the right of a sender to revoke or amend its payment order. Those rules must be known by the personnel of the receiving bank for the bank to carry out its obligations properly.

75. This suggests that, if the law of the several States involved in a credit transfer are to apply to the various segments of the transfer, the law applicable to any given segment should be the law of the receiving bank. In a transfer involving only two banks in different States, the law governing the segment from the originator to the originator's bank would be governed by the law of the State where the originator's bank was located and the segment from the originator's bank to the beneficiary's bank by the law of the State where the beneficiary's bank was located. Similarly, if there was a third country intermediary bank, which might be a reimbursing bank, the law governing the segment where that bank was the receiving bank would be the law of the State where that bank was located. Finally, the consequences of the credit transfer on the beneficiary's account would be governed by the law of the State where the beneficiary's bank was located.

76. The general appropriateness of this suggested rule can easily be verified by examination of the current draft

of the Model Law. Most of the provisions set out either an operational rule to be carried out by the receiving bank or the legal consequences of a failure by the receiving bank to carry out its obligations.

77. A general rule that the law governing a segment is the law of the State where the receiving bank is located must, nevertheless, take account of the fact that certain provisions in the draft Model Law are stated in terms of the sender or consider a relationship other than that of the sender and receiving bank. Those provisions may be considered to be representative of the problems that will be faced in applying any set of rules on conflict of laws to credit transfers. The provisions that need to be considered are as follows:

*Article 4.*

(1) The paragraph as drafted would seem to indicate that the question whether the actual sender had power to bind the purported sender would be determined by the relevant law applicable to the purported sender.

(2) and (3) The two paragraphs are drafted in terms of whether the purported sender is bound by the payment order. However, the verification of the authentication of the payment order would take place at the receiving bank. Therefore, it would seem appropriate that the law of the State where the receiving bank is located would determine the commercial reasonableness of the authentication provided and of the legal effect of compliance with the required procedures by the receiving bank. Since paragraph (3) is an exception to paragraph (2), it should be subject to the same law.

(4) The obligation of the sender to pay the receiving bank arises because the receiving bank has acted at the request of the sender. The determination as to which actions of the receiving bank give rise to the sender's obligation would seem to be determined best by the law of the State where the receiving bank is located.

*Article 5.*

Subparagraph (3)(b) provides that, where the transfer is not successfully carried out the receiving bank must refund to its sender any funds it has received from its sender and "the receiving bank is entitled to the return of any funds it has paid to its receiving bank". In effect, paragraph (3)(b) calls for the return of the funds paid by the receiving bank under article 4(4) in its capacity as a sender and the quoted portion of the provision is redundant, although it serves the general purpose of assuring the bank that it is not intended to bear the ultimate loss. Since the law governing the obligation of the receiving bank as a sender would be governed by the law of the State where "its receiving bank" is located, the law of "its receiving bank" would appropriately govern the obligation to return the funds.

*Article 8(1) to (4).*

Although phrased in terms of the sender's right to revoke or amend a payment order, the substantive rules depend upon whether the receiving bank has acted on the payment order.

(5) Although the paragraph is drafted in terms of the rights and obligations of the sender, it could equally well be drafted in terms of the rights and obligations of the receiving bank.

(6) This paragraph should be compared with article 4(1), (2) and (4). If viewed as a question of the personal capacity of the sender, the law of the sender would be appropriate. If viewed as the authority of a receiving bank to act on a payment order received and to debit the account of the sender or otherwise receive payment from the sender, the law of the receiving bank would be appropriate.

*Article 11(1) to (3).*

The paragraphs relate to the discharge of the underlying obligation. It would seem that the appropriate law would be the law of the State where the obligation is to be discharged, as provided in article 12(2). The determination of the State where the obligation is to be discharged would be outside the scope of the Model Law.

78. There may be occasions when banks or other entities which regularly exchange payment orders may wish to choose the law of some other jurisdiction to govern their rights and obligations in respect of those payment orders. The current draft of article 12(1) suggests that in addition to the law of the receiving bank, the parties might choose the law of the sender or the law of the State in whose currency the payment orders are denominated. Yet another conceivable choice might be the law of the State where the communication service the two banks use for international payment orders is located.

79. After the Working Group has considered the territorial application of the Model Law, it may wish to consider whether the Model Law should contain an additional provision on choice of law. If a separate provision is to be prepared, the Working Group may think it appropriate for that provision to be consistent with the provision on the territorial application of the Model Law.

80. The unfortunate aspect of the analysis of territorial application of the Model Law and of choice of law in general is that a single international credit transfer will always be governed by the law of at least two, and often more, States. That emphasizes the importance of preparing a Model Law that has a high likelihood of widespread adoption.

**D. Report of the Working Group on International Payments on the  
work of its twentieth session**  
(Vienna, 27 November-8 December 1989) (A/CN.9/329) [Original: English]

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**INTRODUCTION**

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

2. The Working Group undertook the task at its sixteenth session (Vienna, 2-13 November 1987), at which it considered a number of legal issues set forth in a note by the Secretariat. The Group requested the Secretariat to prepare draft provisions based on the discussions during its sixteenth session for consideration at its seventeenth session. At its seventeenth session (New York, 5-15 July 1988) the Working Group considered the draft provisions prepared by the Secretariat. At the close of its discussions the Working Group requested the Secretariat to prepare a revised draft of the Model Rules. At its eighteenth session (Vienna, 5-16 December 1988) the Working Group began its consideration of the redraft of the Model Rules, which

it renamed the draft Model Law on International Credit Transfers. At its nineteenth session it continued its consideration of the draft Model Law.

3. The Working Group held its twentieth session in Vienna from 27 November to 8 December 1989. The Group was composed of all States members of the Commission. The session was attended by representatives of the following States members: Argentina, Bulgaria, Cameroon, Canada, Chile, China, Costa Rica, Czechoslovakia, Denmark, Egypt, France, Germany, Federal Republic of, Hungary, India, Iran (Islamic Republic of), Iraq, Italy, Japan, Kenya, Libyan Arab Jamahiriya, Mexico, Morocco, Netherlands, Nigeria, Singapore, Spain, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United States of America, and Yugoslavia.

4. The session was attended by observers from the following States: Australia, Austria, Bolivia, Colombia, Dominican Republic, Finland, German Democratic Republic, Ghana, Guatemala, Kuwait, Israel, Oman, Pakistan, Peru, Philippines, Poland, Republic of Korea, Romania, Saudi Arabia, Sweden, Switzerland, Thailand, Turkey, Uganda, and Ukrainian Soviet Socialist Republic.

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

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

6. The Working Group elected the following officers:

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

*Rapporteur:* Mr. Bradley Crawford (Canada)

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

(a) Provisional agenda (A/CN.9/WG.IV/WP.43);

(b) International Credit Transfers: Comments on the draft Model Law on International Credit Transfers, report of the Secretary-General (A/CN.9/WG.IV/WP.44).

8. The Working Group adopted the following agenda:

(a) Election of Officers.

(b) Adoption of the agenda.

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

(d) Other business.

(e) Adoption of the report.

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

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

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

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

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

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

10. The text of the draft Model Law before the Working Group was that set out in the report of the nineteenth session of the Working Group (A/CN.9/328, annex) and reproduced with comments in A/CN.9/WG.IV/WP.44.

### *Title of the draft Model Law*

11. The title was accepted subject to later discussion as to the sphere of application as set out in article 1.

## *Article 1*

### *Concept of internationality*

12. Under one view the Model Law should apply to domestic as well as to international credit transfers. It was stated that credit transfers are increasingly processed through electronic systems that do not distinguish between transfers that are purely domestic and those that have contact with two or more countries. It would cause operational problems if two different laws were to apply to credit transfers passing through such systems, one law for transfers originating in or destined for another country and another for transfers that were purely domestic. It was also stated that legislators considering the Model Law would find it difficult to understand why a law should be adopted for international credit transfers when no State at the present time has enacted a comparable law for domestic credit transfers.

13. Under another view the sphere of application of the Model Law should continue to be restricted to international credit transfers. Even though the mandate given the Working Group would permit the Working Group to prepare a model law that would apply to domestic credit transfers, the entire context within which the Model Law was being prepared was that of international transfers. It was stated that the problems faced in international credit transfers were different from those faced in domestic credit transfers, particularly in regard to the risks for bank and customer alike. Some States that have a long history of domestic credit transfers might be willing to adopt the Model Law if it applied only to international credit transfers, but would not be willing to modify their existing practices and rules governing domestic credit transfers. It was also pointed out that, while there was a certain similarity to the problems faced by all countries in making international credit transfers, the problems faced by different countries and, therefore, the appropriate legal rules to govern domestic credit transfers, differed widely.

14. It was also suggested that, even if the Model Law was limited by its own terms to international credit transfers, some States might wish to apply it to domestic credit transfers as well. Therefore, it was not necessary to confront the difficult political problems that might be created by providing in the Model Law that it applied to all credit transfers.

15. After discussion the Working Group decided that the sphere of application of the Model Law should continue to provide that it would apply only to credit transfers that were international in character.

### *Criteria for internationality*

16. There was general agreement that the test for the internationality of a credit transfer as formulated in article 1 was too restrictive. The examples set forth in A/CN.9/WG.IV/WP.44, article 1, comments 4 to 6 were noted. In those comments it was pointed out that a bank that originated a credit transfer for its own account was an originator and not an originator's bank, and a bank that received credit for its own account was a beneficiary and not a beneficiary's bank. Therefore, a transfer by the bank

as originator to a second bank as beneficiary made by instructing their mutual correspondent bank to debit and credit the appropriate accounts held with it would not be an international credit transfer and the Model Law would not apply even if the three banks were in different States. That result would ensue because there would not be an "originator's bank" and a "beneficiary's bank" in different States.

17. In contrast, if the transfer in the example above was made on the instruction of a customer or for the benefit of a customer, there would be an originator's bank and a beneficiary's bank in different States and the Model Law would apply.

18. Under one view the transfer should be considered to be international and the Model Law should apply if any two parties, the originator, beneficiary or a bank were in different States. Under that view a credit transfer involving only one bank would be an international credit transfer so long as either the originator or the beneficiary was in a different State. A question was raised whether being in another State referred to physical location when the payment order was issued or whether it referred to residence.

19. Under another view the Model Law should apply only if the banking systems of two different States were involved. Under that view the Model Law would apply to the example in paragraph 16 but would not necessarily apply to the example in paragraph 18.

20. Furthermore, under that view the Model Law would also apply to the transfer in which the originator's bank and the beneficiary's bank were in the same State but an intermediary bank was in a different State. It was questioned whether a settlement bank in a second State should be considered to be an intermediary bank and whether such a transfer should fall within the Model Law. It was pointed out, however, that the originator's bank had the choice of routing the credit transfer through the bank in the second State, in which case that bank was undoubtedly an intermediary bank, or issuing two payment orders, one to the beneficiary's bank and the second to the bank in the other State instructing it to credit the account of the beneficiary's bank. It was stated that under the current definition of intermediary bank, a settlement bank would be an intermediary bank. (For further discussion whether a settlement bank should be considered to be an intermediary bank, see paragraphs 70 and 71, below.)

21. It was suggested that one means to cover the example set forth in paragraph 16 would be to change the definition of originator's bank and beneficiary's bank to include the cases where the originator or the beneficiary was itself a bank. That suggestion was objected to on the grounds that it would change the definitions from the meaning commonly ascribed to them in the banking community.

22. A concern was expressed that, whatever be the final criteria of internationality, a receiving bank should be able to tell from the payment order received that the Model Law would apply to the transfer. It was stated that it would be of particular importance that a receiving bank

could do so when the operational rules under the Model Law were different from the equivalent operational rules under the otherwise applicable law. (For further discussion of the need for a receiving bank to be able to determine from the payment order whether the Model Law would apply to the transfer, see paragraphs 55, 56, 88 and 93, below.)

23. After discussion the Working Group decided to add to paragraph (1) the words "or, if the originator is a bank, that bank and its receiving bank are in different countries." (For the reaction of the Working Group to the change in the wording by the drafting group, see paragraph 194, below.)

#### *Consumer transfers*

24. There was no support for a suggestion that the footnote to article 1 needed to be made clearer that the Model Law does not cover consumer protection issues or to move the footnote into the body of the article.

#### *Drafting suggestion*

25. The Working Group agreed that, in order to remove a possible ambiguity, the text of paragraph (2) should refer to "branches of a bank" in different countries.

### *Article 2*

26. The Working Group decided to add as a *chapeau* to the article the words "For the purposes of this law:".

#### *Credit transfer*

27. It was recognized that the definition of "credit transfer", as well as the associated definition of "payment order", was of particular importance since article 1 on the sphere of application of the Model Law provided that the law applied to credit transfers. Therefore, the definition of the term served in part to determine the sphere of application of the Model Law.

28. The discussion in the Working Group focused on a new proposed definition. That proposal, after certain drafting changes which did not go to its substance, was as follows:

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

29. It was pointed out that the proposed definition differed from the existing definition in that a credit transfer was defined in terms of the actions taken in regard to payment orders and not in terms of the movement of funds. It was stated that any remaining problems in regard to determining the types of transfers to be covered could be handled in the definition of "payment order". At the

same time that the proposed definition of "credit transfer" was submitted to the Working Group, a new definition of "payment order" was also submitted.

30. The Working Group accepted the first two sentences of the proposal subject to certain drafting suggestions already incorporated into the definition as set out in paragraph 28, above. The primary discussion was on the third sentence.

31. It was stated that the third sentence was appropriate for two reasons: First, while the time of completion was implied in such provisions as articles 11 and 14, the draft Model Law did not currently state clearly when a credit transfer was completed. Secondly, since the definition would state when a credit transfer began, it would be logical for the definition to state when the credit transfer ended. The proponents of the proposed definition agreed, however, that it was not essential for the third sentence to be part of the definition of "credit transfer".

32. In opposition to including the third sentence it was said that a statement as to the moment of completion of a credit transfer was too important to be found in a definition; it should be in a completely separate provision. Opposition was also expressed to completion of a credit transfer being determined by acceptance of a payment order by the beneficiary's bank. It was recognized, however, that that question was a matter of substance which did not have to be considered at that time.

33. The Working Group decided to adopt the definition as proposed but to place the third sentence in square brackets. Placing the third sentence in square brackets was intended to indicate that neither the substance of a rule as to when a credit transfer was completed nor the location of such a rule was being decided at that time.

#### *Payment order*

34. The Working Group was in agreement that the definition of "payment order" should follow immediately after the definition of "credit transfer" since, in effect, the definition of a "credit transfer" would depend on the definition of a "payment order".

35. The following definition of "payment order" was proposed in association with the definition of "credit transfer" that had been adopted:

"'Payment order' means an instruction of a sender to a receiving bank, transmitted orally, electronically, or in writing, to pay, or to cause another bank to pay, a fixed or determinable amount of money to a beneficiary if:

- (i) the instruction does not state a condition to payment to the beneficiary other than the time of payment,
- (ii) the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender, and
- (iii) the instruction is transmitted directly to the receiving bank or to an agent, funds transfer system, or communication system for transmittal to the receiving bank."

36. In regard to the *chapeau*, it was agreed that the words "to pay, or to cause another bank to pay ... to a beneficiary" should be replaced by "to place at the disposal of a designated person".

37. It was stated that the list of means of transmitting a payment order was incomplete as it left no room for further developments of technology, such as light impulses over fibre optical cable. Furthermore, it was not clear whether the current list would be interpreted to include the manual transmission of magnetic tapes. It was suggested that those examples showed that it would be preferable not to list the means of transmission but to use some more general formula.

38. A substantial discussion took place as to the appropriateness of including oral payment orders in the list. It was noted that in some countries banks were not permitted to accept oral payment orders. In other countries there was no prohibition on oral payment orders, and banks accepted them at their own risk. In some of those countries oral payment orders transmitted by telephone were current practice, though they were relatively rare.

39. It was suggested that in place of a list of permissible means of transmitting a payment order the words "by any means" might be used. The prevailing opinion was that any reference to the means of transmittal might be deleted entirely. If an issue arose, it would be settled under national law.

40. In favour of the proposed provision that an instruction was a payment order only if it did not state a condition to payment to the beneficiary other than the time of payment, it was stated that the Model Law should be designed for modern high-speed, low-cost funds transfer systems. Conditional instructions could not be handled automatically but required human intervention. Unless conditional instructions were eliminated from the definition of payment orders even such matters as an instruction to open a letter of credit would be a payment order. Furthermore, if conditional instructions were considered to be payment orders, at least article 9 on the time within which a receiving bank had to act would have to be reconsidered, and perhaps other articles as well.

41. In opposition to the proposed provision it was stated that conditional payment orders were common and would continue to exist whether or not they were considered to be payment orders under the Model Law. Many conditions were easy to comply with. Banks would not normally be willing to accept payment orders with conditions attached whose fulfilment could not easily be verified. The consequence of considering conditional payment orders not to be payment orders under the Model Law might be to exclude the entire credit transfer from the sphere of application of the Model Law. That would be prejudicial to subsequent banks which would have no way of knowing that the originator's order had been conditional.

42. Various suggestions were made as to how a conditional payment order might be made subject to the Model Law but with its effects limited to the originator's bank. It was stated that a condition placed by the originator on



his order to the originator's bank would not be passed on by that bank in its own payment order to its receiving bank. It was suggested that one way of arriving at the proper result would be to consider the condition in the originator's payment order to be a collateral agreement that bound the originator's bank but that did not affect the validity of that bank's own payment order, even if issued in violation of the condition.

43. It was stated that use of the word "directly" in the third element of the definition of "payment order" would eliminate from the definition, and therefore from the sphere of application of the model law, certain transfers that should be included in which a payment order was transmitted by the originator to the beneficiary for further transmission to the originator's bank.

44. After discussion a small working party was charged with the task of re-drafting the proposed definition in the light of the discussion.

45. The small working party proposed the following definition of "payment order":

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

- (i) the instruction contains no conditions other than conditions imposed by the originator which are to be satisfied on or before the issue of a payment order by the originator's bank,
- (ii) the receiving bank is to be reimbursed by debiting an account of, or otherwise receiving payment from, the sender,
- (iii) the instruction is to be transmitted directly to the receiving bank, or to an intermediary, a funds transfer system, or a communication system for transmittal to the receiving bank, and
- (iv) the instruction is not intended to establish a letter of credit."

46. In order to implement the fourth element of the proposed definition the small working party also proposed a definition of "letter of credit" adapted from the Uniform Customs and Practice for Documentary Credits, article 2 (International Chamber of Commerce, Publication No. 400) as follows:

"Letter of credit" means any arrangement, however named or described, whereby a bank acting at the request and on the instructions of a customer,

- (i) is to make a payment to or to the order of a third party or is to pay or accept bills of exchange drawn by the third party, or
- (ii) authorizes another bank to effect such payment, or to pay, accept or negotiate such bills of exchange against stipulated documents, provided that the terms and conditions of the arrangement are complied with."

47. It was reiterated that the definition of "payment order", like that of "credit transfer", was of particular importance because it helped determine the sphere of application of the Model Law. Furthermore, the obliga-

tions of receiving banks were set out in terms of the actions they had to take in regard to payment orders they received. Therefore, if the message they received did not meet the definition of a payment order, the Model Law would impose no obligations on the receiving bank in regard to that message. In addition, under the Model Law a receiving bank other than the beneficiary's bank that accepted a payment order was obligated to issue its own payment order. If the message it issued did not meet the definition of a payment order, the bank would have failed in its obligations under article 6.

48. A question was raised whether an instruction was for a fixed or determinable amount of money, and therefore whether the instruction was a payment order, if the instruction was to credit the beneficiary's account for 100,000 francs, without stating whether Swiss, French or Belgian francs were envisaged and the instruction was issued in and sent to a country other than one of the those three. In reply it was stated that it was clear that in such a case the receiving bank should have a duty under article 6 to enquire of its sender as to the meaning of the order. It was decided that when the Working Group considered article 6, it would provide for that case and other similar questions of ambiguity. (See paragraph 132, below.)

49. The *chapeau* of the proposed definition was adopted with the addition of the words "by an identified sender".

50. It was noted that the new formulation of the provision on conditions deleted any reference to the time of payment, which was said not to be a condition but was a term of the instruction. The new formulation also provided that an instruction could be considered to be a payment order only if any conditions contained therein were to be satisfied on or before the issue of a payment order by the originator's bank. If an instruction contained a condition that had to be satisfied prior to action by a bank subsequent to the originator's bank, the instruction was not a payment order. It was said that a transfer based upon an instruction containing such conditions was outside the sphere of application of the Model Law.

51. It was explained that a payment order issued by the originator's bank might on occasion contain a condition that had to be satisfied before the originator's bank was authorized to act, since on occasion the bank might simply copy the instruction received. The copying of such a condition would not take the instruction of the originator's bank outside the definition of payment order. Furthermore, it was intended that the receiving bank of the payment order from the originator's bank would have no obligation to enquire whether the condition had been fulfilled. The payment order it received should be considered to be clean. The Working Group did not adopt a proposal that a separate article be inserted to specifically state that result.

52. Some opposition was expressed to even such a restricted recognition of conditional payment orders as falling within the sphere of application of the Model Law. It was noted that article 5(1) did not currently give the originator's bank any extra time within which to consider conditional orders before the bank was deemed to have

accepted the order. Article 9 was also not of help because it provided only the amount of time that a bank had to execute an order that had been accepted.

53. A concern was expressed as to whether the understanding as to what was a condition was the same in civil law legal systems as it was in common law legal systems. It was said that that concern might be overcome by appropriate drafting.

54. The opposition to using the word "directly" in the third element of the definition that had been previously expressed was restated. The drafting group was requested to find another term to express the idea.

55. It was proposed that the definition of a payment order should include the requirement that it include an indication of the identity of the originator's bank. It was said that only in that way would a subsequent bank be able to tell that the payment order received was in the context of an international credit transfer that would be subject to the Model Law.

56. There was general agreement that the problem the proposal was intended to overcome was important. However, while the proposal received some support, perhaps to be placed in a separate article, the prevailing view was that indication of the originator's bank should not be included as part of the definition of a payment order. It was stated that such a requirement might be appropriate if the term being defined was "international payment order" rather than "payment order". It was also stated that the problem would be overcome if national legislators used the Model Law as the basis for their domestic law covering all credit transfers. A particular problem with the proposal was that an intermediary bank that did not include the indication of the originator's bank would not have issued a payment order. The entire scheme of the Model Law would be disturbed, including such matters as when the credit transfer initiated by the originator was completed.

57. The proposed definition of "payment order" was adopted as amended.

58. The proposed definition of "letter of credit" was not adopted. It was stated that such a definition was not necessary in the Model Law for the limited purpose for which it had been proposed. Moreover, the definition did not include the important provision found in article 10 of the Uniform Customs and Practice that the credit constituted a definite undertaking of the issuing bank to pay or that payment would be made if the stipulated documents were presented.

#### *Originator*

59. The definition was adopted.

#### *Beneficiary*

60. The definition was adopted with the words "the ultimate person intended" changed to "the person designated in the originator's payment order".

#### *Sender*

61. The definition was adopted with the word "sends" changed to "issues".

#### *Bank*

62. It was stated that the current definition of a bank was not clear in several respects. The term "financial institutions" might be understood in different ways in different countries, particularly if there was domestic legislation that applied to financial institutions generally. A second source of difficulties was that the definition required a determination whether the institution engaged in credit transfers for other persons as an ordinary part of its business. It was pointed out that the words "engages in credit transfers for other persons" might be understood to mean that financial institutions that engaged only in transmitting payment orders but not in moving funds would be included in the definition of a "bank".

63. To overcome those problems the following definition was suggested:

"'Bank' means an entity which, as an ordinary part of its business, engages in executing payment orders and moving funds to other persons."

64. There was discussion whether it was intended that post offices would be included under the definition of banks, thereby making them subject to the Model Law. It was noted that in many, but not in all, countries the post office furnished an active credit transfer service. In many cases the post office also took deposits, thereby fulfilling most of the traditional functions of a bank.

65. Under one view the Model Law was intended to govern credit transfers executed by the traditional banking system. Even where the post office engaged in credit transfers for others, it was subject to different rules arising out of its administrative status. Therefore, the definition of a bank should not include such entities as the post office and should be restricted to a more traditional concept. It was also pointed out that in a number of countries commercial entities such as petroleum companies were establishing point-of-sale systems. At least in Europe it could be expected that those point-of-sale systems would operate internationally. However, they raised problems that were so different from those intended to be covered by the Model Law that it should be clear that they were excluded from the sphere of application.

66. Under the prevailing view the Model Law was intended to govern a service and not particular systems. If the post office, or any other type of entity, offered a credit transfer service of the same nature as did banks, it was important that it be subject to the same rules as were the banks. If the banks, for example, were subject to the money back guarantee of article 11 but the post office was not, there would be an imbalance in the competitive situation between the two.

67. As to the point-of-sale systems, it was said that it was unlikely that they would fall under either the current or the proposed definition of a bank. In any case, it was likely

that they would be subject to specific legislation governing the rights and obligations of consumers referred to in the footnote to article 1.

68. After discussion the proposed definition was adopted.

#### *Receiving bank*

69. The definition was adopted.

#### *Intermediary bank*

70. A proposal was made that a settlement bank that was not in the chain of banks between the originator's bank and the beneficiary's bank should not be considered to be an intermediary bank. It was said that settlement was a separate function from that of executing the credit transfer as instructed in the originator's payment order. A single settlement might be for a number of transfers with different information in the settlement payment order than in the payment orders for which settlement was being made, and the settlement might also be on a net basis. It was also noted that ISO 7982-1 defined an intermediary bank as a bank "between the receiving bank and the beneficiary's bank through which the transfer must pass if specified by the sending bank".

71. The proposal was not adopted. Concern was expressed that the exclusion of settlement from the definition of intermediary bank might also exclude the settlement from the sphere of application of the Model Law, at least where the three banks involved in the settlement were all in the same country, and that as a result the rights of the originator's bank to the money back guarantee in article 11 might be affected. As to the ISO definition, it was noted that it had been drafted in the context of the messages passing between two banks and that in that context the only intermediary banks of relevance were those specified in the payment order as banks through which the credit transfer would have to pass on the way to the beneficiary's bank. Article 6(5) used the term "intermediary bank" in the same sense as did the ISO definition, but other articles did not.

72. A proposal was adopted to delete the words "any bank executing a payment order" and to insert the words "any receiving bank". The following proposal was referred to the drafting group for its consideration:

"Intermediary bank' means any bank other than the originator's bank and the beneficiary's bank that is involved in the process of receiving and executing the payment order."

#### *Funds or money*

73. It was noted that the definition included the ECU.

#### *Authentication*

74. The Working Group considered the proposed definition of "authentication" contained in A/CN.9/WG.IV/WP.44, comment 23 to article 2, which was as follows:

"Authentication' means a procedure established by agreement to determine whether all or part of a payment

order or a revocation of a payment order was issued by the purported sender or whether there has been an error in its transmission or in its content."

75. It was noted that the proposed revision was intended to cover two separate problems: extension of the definition of authentication to revocations under article 10 and extension of the definition of authentication to procedures under article 4(2) to determine whether there had been an error in the transmission of a payment order or in its content.

76. The Working Group was in agreement that if the scheme for revocation of payment orders currently set out in article 10 remained as it was, the authentication procedure of article 4 should apply. Therefore, the proposed definition of "authentication" through the words "was issued by the purported sender" was adopted as suggested. However, since there remained opposition in the Working Group to the basic scheme of article 10, the words "or a revocation of a payment order" were placed in square brackets, pending further discussion in the context of article 10.

77. As to the extension of the definition of "authentication" to errors in transmission or in the content of a payment order, there was widespread support for the view that the extent to which a receiving bank should be responsible for detecting such errors should be covered by the Model Law. Under one view the suggested approach in regard to the definition and the associated suggested modification of article 4(2) set out in A/CN.9/WG.IV/WP.44, comment 10 to article 4 were appropriate.

78. Under the prevailing view the problems of authentication of a payment order as to its source and verification of the accuracy of its contents were two different problems as a matter of legal concepts, even if in some circumstances the same technical procedures might be used for both. In respect of the source of a message, the basic rule in article 4(1) was that the purported sender was not bound by a payment order unless he had in fact issued it or authorized its issue. From a legal point of view the authentication defined in article 2 and used in article 4(2) served to describe situations in which the purported sender might be bound by a payment order in spite of the fact that it had not been issued or authorized by him.

79. In respect of errors in a payment order and corruption of the contents of a payment order during its transmission, it was said that the general rule was that the sender was bound by what was received by the receiving bank. If it was intended that the Model Law relieve the sender of that responsibility because of the availability of a procedure agreed between the sender and the receiving bank that would detect the error or corruption, that intention should be set out separately in the Model Law. Therefore, the Working Group did not accept the part of the proposed definition relating to errors and corruption of a payment order.

*Cover*

80. In connection with the later discussion of article 5(2)(b) an amendment to that article was adopted that eliminated the use of the word "cover". Since it was understood that an identical amendment would be made to article 7(2)(b), it was decided that there was no further use for the term and the definition was deleted, subject to any later amendments to substantive provisions that re-introduced the term. (See paragraph 126, below.)

*Execution date, pay date*

81. Discussion of those definitions was deferred pending discussion of article 9. (See paragraph 182, below.)

*Value date*

82. The definition was deleted since the term was no longer used in the Model Law.

*Article 3**Proposed definition of "beneficiary's bank"*

83. In connection with article 3(v), which provided that a payment order was required to contain the identification of the beneficiary's bank, it was proposed that a definition of "beneficiary's bank" be adopted as follows:

"'Beneficiary's bank' means the last receiving bank involved in a credit transfer."

84. It was said that such a definition would be useful since, although the beneficiary would normally have an account at the beneficiary's bank, that was not always the case.

85. It was also suggested that the definition should make it clear that the beneficiary was also considered to be the beneficiary's bank when the beneficiary was a bank. It was pointed out that this was not the case under the current text since the beneficiary, whether or not a bank, does not receive a payment order; instead it receives an advice of credit.

86. The proposal was not adopted.

*Consideration of article*

87. Several suggestions were made as to additional data elements that might be considered for inclusion in article 3 as mandatory data elements. It was suggested that information on cover be included. It was also suggested that indication of the originator be included since that information was necessary for article 14(2) on discharge of the underlying obligation to function properly.

88. It was suggested that the identification of the originator's bank be included in article 3, because subsequent banks would need to know whether the credit transfer was international and fell within the sphere of application of the Model Law. For the same reason it was also suggested that in view of the amendment to article 1(1) it would be necessary to specify on the payment order whether the originator was a bank. It was stated that adoption of the

proposals should not affect the application of the Model Law to the credit transfer; they were intended only to assure that subsequent receiving banks would receive the information they would need. In response to an enquiry as to whether requiring such information on payment orders would not require banks to include information that would otherwise be considered to be irrelevant, it was stated that the SWIFT and ISO formats had an applicable field, but that it was an optional rather than a mandatory field and should be used when the sending bank and the originator's bank were not the same. Other communication or funds transfer systems might not have such a field currently available.

89. The Working Group discussed what the consequences would be if a sender failed to include one of the mandatory data elements listed in article 3. It was noted that comment 1 to article 3 in A/CN.9/WG.IV/WP.44 stated that the Working Group had included the set of minimum mandatory data elements to fulfil an educational function.

90. It was stated that a message that failed to include a mandatory data element listed in article 3 was not a payment order. In reply it was stated that only the data elements contained in the definition of a payment order in article 2 were necessary for a message to be a payment order. The drafting group at the nineteenth session of the Working Group had moved the data elements currently found in article 3 from the definition of a payment order in article 2. That had been done in order to avoid the conclusion that a message that otherwise qualified as a payment order was not a payment order merely because it failed to include one of those data elements.

91. It was stated that, if a payment order failed to include the name of the sender as required by article 3(i), it would be impossible for the receiving bank to notify the sender of the rejection of the payment order as required by article 5(1). It was also stated that the consequences arising out of the omission of any relevant data element that made it impossible for the receiving bank to execute the payment order should be considered under article 6 or 8.

92. The view was expressed that article 3 should be deleted. In contrast to the bill of exchange, where minimum mandatory data elements were necessary because of the negotiable character of a bill of exchange, no such necessity existed in respect of a payment order.

93. After discussion the Working Group decided to delete article 3 and to consider the problems of incomplete payment orders in articles 5 to 8, where the problems arose, and to address in some other provision the need for payment orders to disclose to receiving banks that the payment order formed part of an international credit transfer.

*Article 4**Paragraph (1)*

94. The Working Group considered whether to adopt Variant A or Variant B of the paragraph. It was generally

agreed that there was no intended difference in substance between the two variants. It was stated that, while Variant A spoke of the applicable law and Variant B did not, the determination of the law applicable to the question whether the actual sender of a payment order had the power to bind the purported sender by issuing the payment order was an inherent problem, whichever of the two variants was chosen. It was also stated that it would not be appropriate to set forth in the Model Law a choice of law rule on this point, although the applicable law would undoubtedly be that of the purported sender of the payment order.

95. After discussion of various points of terminology in the two variants, it was decided to adopt Variant B. The drafting group was requested to consider the terminology in the different language versions to ensure uniform meaning.

96. As had been decided in respect of the definition of "authentication" (see paragraph 76, above), the words "or a revocation of a payment order" were added in square brackets pending the subsequent discussion to be held on article 10.

#### Paragraph (2)

97. The suggestion was made that subparagraph (a) should state a more precise test than that the authentication provided was "commercially reasonable". Under one view the word "reasonable" always had to be interpreted in the context of the factual situations presented. Under that view the word "commercially" either was redundant or, if it was not redundant, it would confuse the courts. Under another view the word "commercially" would help explain the context in which the determination as to whether the authentication was reasonable should take place. It was stated that any agreement between banks as to the authentication to be used for payment orders between them would be reasonable.

98. Under yet another view many legal systems were unfamiliar with the concept of "reasonable" and would find it difficult to interpret, whether or not the word was modified by "commercially". In that regard it was suggested that any commentary written to accompany the Model Law once it was adopted by the Commission might give an indication as to the factors that might be taken into account. It was also pointed out that several conventions that had been prepared by the Commission used the term "reasonable".

99. Following discussion the Working Group decided not to modify subparagraph (a).

100. A proposal was made to delete subparagraph (b). In support of the proposal it was stated that the obligation of the sender to pay the receiving bank arose in article 4(4) on acceptance of the payment order by the receiving bank and that the issue as to whether there was cover available for the payment order should not enter into the definition of "authentication".

101. In opposition to the proposal it was stated that paragraph (2) provided a broad rule that a purported sender

might be bound by a payment order that he had neither issued nor authorized; subparagraph (b) gave him one additional element of protection. Furthermore, paragraphs (2)(b) and (4) considered different problems in that paragraph (2)(b) set forth the requirement that cover be available under the terms there described as a condition precedent to the purported sender being bound on a payment order under paragraph (2). Following discussion the proposal was not adopted.

102. It was decided to change the words in subparagraph (b) "are to be" to "may be" so that the subparagraph would cover situations in which the receiving bank had the authority, but not the obligation, to execute payment orders despite the absence of a withdrawable credit balance or an authorized overdraft.

#### Paragraph (3)

103. Following several interventions in favour of Variant A and several in favour of Variant B, a third proposal was made based upon the *chapeau* of Variant A, subparagraphs (a) and (b) of Variant B followed by subparagraph (b) of Variant A. The proposal read as follows:

"A purported sender that is not a bank is, however, not bound by a payment order under paragraph (2) if

- (a) the actual sender was a present or former employee or agent of the receiving bank, or
- (b) the actual sender was a person acting in concert with a person described in subparagraph (a), [or] [and]
- (c) the actual sender had gained access to the authentication procedure without fault on the part of the purported sender.

104. A certain amount of support was given for the proposal if subparagraph (c) was in the alternative, i.e. if it was a third possible means for the sender who would otherwise be bound by the payment order under paragraph (2) to be free of that obligation. In general that position was taken by those delegations who otherwise supported Variant A.

105. A certain amount of support was also given to the proposal if subparagraph (c) was in the conjunctive, i.e. the sender would have to prove either (a) or (b) plus (c). In general that position was taken by those delegations who otherwise supported Variant B. It was recognized that adoption of this version of the proposal would require restructuring the presentation of the paragraph.

106. Different suggestions that were made in regard to the proposals before the Working Group were that the rule in paragraph (3) should be subject to the contrary agreement of the parties; that the bank should have the burden to justify a debit to the sender's account when the sender was a depositor of the receiving bank, but that such a rule was not appropriate when the sender was not a depositor of the receiving bank; and that the risk of loss from uncertain events should be on the receiving bank when the sender was not a bank and the sender showed that he had taken all reasonable precautions.

107. During the discussion it was suggested that the Working Group should also have before it Article 4A-203(2) and (3) of the Uniform Commercial Code in the form in which Article 4A had recently been approved for adoption in the United States of America. Those two paragraphs are as follows:

“(2) By express written agreement, the receiving bank may limit the extent to which it is entitled to enforce or retain payment of the payment order.

(3) The receiving bank is not entitled to enforce or retain payment of the payment order if the customer proves that the order was not caused, directly or indirectly, by (i) a person entrusted at any time with duties to act for the customer with respect to payment orders or the security procedure [equivalent to authentication in the terminology of the Model Law], or (ii) a person who obtained access to transmitting facilities of the customer or who obtained, from a source controlled by the customer and without authority of the receiving bank, information facilitating breach of the security procedure, regardless of how the information was obtained or whether the customer was at fault. Information includes any access device, computer software or the like.”

108. The Working Group decided to leave the text unchanged and to return to the question at its next session.

#### *Paragraph (4)*

109. The Working Group discussed whether the paragraph was correct when it provided that payment by the sender for the payment order was due on the execution date, since the execution date was defined in article 2 as the date the receiving bank was obligated to execute the order and not as the date when the receiving bank had performed its obligation. Under one view the sender should not be obligated to pay for its payment order until the receiving bank had acted upon it. Under another view the sender should be obligated to pay on the execution date, but the sender should receive interest under article 12 for the period of any delay of the receiving bank to execute the order.

110. It was suggested that a word other than “pay” should be used and that, in any case, it should be made clear that the obligation in article 4(4) referred only to the amount of the payment order and not to any costs or charges of the receiving bank. Such costs or charges should not be dealt with in the Model Law, except perhaps in respect of the problem treated in article 14(3). Another suggestion was that articles 4(4) and 14(4) were incompatible as to the time indicated since article 14(4) spoke of the acceptance of the payment order by the receiving bank. It was further suggested that the paragraph should be clear that the receiving bank could not contract out of the rule in the paragraph unless the sender was a bank.

111. The Working Group decided to adopt the paragraph and to refer the various drafting points to the drafting group.

### *Article 5*

#### *Proposed definition*

112. A proposal was made to introduce a definition of acceptance as follows:

“‘Acceptance’ means the events set out in articles 5(2) and 7(2).”

113. In support of the proposal it was said that many of the delegations that had expressed their opposition to use of the concept of “acceptance” in past sessions of the Working Group had done so on the basis that although the concept was useful, the term was not because it already had a widely used technical meaning. Others objected to the concept itself because they were concerned about the effect the concept might have on other aspects of banking law. Therefore, if the word was defined, its use would be clearly limited to its role as a convenient drafting technique for the purposes of this Law. It was said that the definition as drafted was awkward, but that it was difficult to draft a better definition without the danger of impinging upon decisions that had already been made.

114. The proposal received no support.

115. In connection with the consideration of article 6 in paragraph 128, below, a new paragraph was added to article 5 indicating that the article applied to receiving banks that were not the beneficiary’s bank.

#### *Paragraph (1)*

116. It was suggested that the receiving bank should not have to notify the sender of a rejection of the payment order if the payment order was so incomplete that it could not be executed. In reply it was stated that the suggestion was too broad. It was said that incomplete data as to the amount of a payment order or the identification of the beneficiary was similar to an inconsistency in the amount of a payment order or the identity of the beneficiary as expressed in words and in figures. It was said that, since articles 6(3), 8(2) and 8(3) required the receiving bank or the beneficiary’s bank to notify the sender of the inconsistency, the same rule should apply in the case of similar incomplete data.

117. In respect of a payment order that did not contain the identification of the sender, it was decided that article 5(1) should be amended to make it clear that no notice of rejection would have to be given by adding the words “unless there is insufficient information to identify the sender”.

118. A proposal was made that a receiving bank should have to notify the sender of a rejection of a payment order only if the sender and the receiving bank had an account relationship with one another. The proposal did not receive sufficient support to be adopted.

119. It was suggested that a receiving bank should have to give notice of rejection of a payment order even if the reason for the rejection was that there were insufficient funds. It was stated that there were many reasons why a sender might not know that it did not have sufficient funds

to cover a payment order that it had sent. It was said that it was good banking practice for the receiving bank to notify the sender whenever the sender's payment order was not going to be executed by the execution date.

120. Under another view the receiving bank should have to give notice of rejection in the rare case that it was furnished with cover that was apparently satisfactory but with which the bank was not satisfied, perhaps because the cover would put the receiving bank's credit balance with the settlement bank beyond the credit limit previously established for that bank. It was said that it was a different situation if the receiving bank had not received a cover message; in that case it should have no obligation to give notice.

121. In opposition to the suggestion that notice should be given in all cases of failure to execute the payment order by the execution date, it was stated that the consequence of failure to give a required notice was too severe when the reason for the failure to execute the order was insufficient funds. The case was hypothesized of a payment order for Swiss francs 100,000,000 that was not executed because of insufficient funds. If a clerk at the receiving bank failed by error to give the required notice, it was said that it would not be appropriate for the Model Law to provide that the payment order had been accepted and that as a result the receiving bank would have to pay SF 100,000,000 out of its own funds.

122. In order to accommodate the different concerns a proposal was made that the words "unless one of the reasons is insufficient funds" should be deleted from article 5(1) and that article 5(2)(a) should also be deleted. The result would be that the receiving bank would have a duty to notify the sender of rejection of a payment order whenever the order was not executed by the execution date, but the failure to give the required notice would result in the damages envisaged by article 12 and not in acceptance of the payment order. That proposal was not adopted by the Working Group.

123. The Working Group accepted a proposal to delete the reference to insufficient funds in article 5(1) but to add it to article 5(2)(a). As a result, the obligation to notify exists in all cases in which a receiving bank does not execute a payment order by the execution date. However, the failure to give the required notice would not lead to acceptance of the payment order if the reason for the failure to execute the order was insufficient funds. (See paragraph 175, below.)

124. The Working Group noted the statement in A/CN.9/WG.IV/WP.44, comment 9 to article 5 that no change in policy was intended by the drafting group at the nineteenth session of the Working Group when it deleted the provision in article 5(1) that the obligation to give notice was subject to the contrary agreement of the sender and receiving bank.

#### *Paragraph (2)*

125. Subparagraph (a) was adopted as modified in paragraph 123, above.

126. Subparagraph (b) was amended by replacing the words "without notification that cover is in place" by the words "when the payment order is received". In support of the amendment it was said that it reflected more accurately the nature of the agreements that were envisaged by the subparagraph.

127. Subparagraphs (c) and (d) were adopted.

### *Article 6*

#### *Paragraph (1)*

128. A question was raised whether the paragraph was necessary since the title of the article already stated that the article applied to the obligations of receiving banks other than beneficiary's banks. In reply it was stated that the titles were not part of the Model Law itself. After discussion the Working Group decided to retain the paragraph and to put a similar paragraph into article 5.

#### *Paragraph (2)*

129. Under one view paragraph (2) should be deleted. In support of that position it was said that an excessive burden was being placed on the receiving bank to require it to notify the sender that a misdirected payment order had been received when the error was that of the sender, or of a party earlier in the credit transfer chain. It was said that the Model Law was being prepared for modern means of transmitting payment orders. In that environment the addressing of payment orders was done primarily by bank identification numbers and not by name.

130. Under another view the paragraph involved two duties: the first was to detect that the payment order was misdirected and the second was to notify the sender of the misdirection. It was said that the Model Law should not set forth a duty to detect the misdirection but that it was appropriate to require notification once the misdirection had been detected.

131. Under the prevailing view the provision was appropriate and should be retained. It was stated that the Model Law would apply not only to computer-to-computer payment orders but also to telex payment orders.

#### *New paragraph*

132. It was noted that an instruction to a receiving bank might not have all the data elements necessary to be a payment order or, alternatively, might have the data elements necessary to be a payment order but not be executable. (See paragraph 48, above.) In accordance with the policy already expressed in articles 6 and 8, the Working Group decided to adopt and refer to the drafting group for possible revision a new paragraph that would read substantially as follows:

"When an instruction does not contain sufficient data to be a payment order or, even though a payment order, it cannot be executed because of insufficient data, but the sender can be identified, the receiving bank is obligated to notify the sender of the insufficiency."

*Paragraph (3)*

133. Under one view the paragraph should be changed to indicate that in case of a discrepancy as to amount, the traditional rule in banking law should be applied that the words controlled over the numbers. One good reason for such a rule was that, if there was an error, it was more likely to be in the numbers than in the words. Under another view the traditional banking rule should not apply in the context of modern electronic means of transmitting payment orders where the payment orders were processed by number. In reply it was said that the paragraph as drafted was a compromise; receiving banks that processed the amount of the payment order by number only were permitted to contract with their customers to that effect.

134. Under yet another view the paragraph was too restricted in that the amount might be represented in clear text by numbers but also be part of a code. In that case the discrepancy might be between two sets of numbers. It was suggested that there should be a reference only to a discrepancy in the amount without saying how that discrepancy might appear.

135. The Working Group decided to retain the paragraph and to refer the last suggestion to the drafting group. The drafting group was also asked to consider inserting a phrase that the duty to notify existed only if the sender could be identified.

*Paragraph (4)*

136. Paragraph (4) was adopted. A suggestion that paragraph (4) be placed before paragraph (2) was referred to the drafting group.

*Paragraph (5)*

137. The use of the term "good faith" was questioned. It was said that different legal systems interpreted the term in different ways. It was suggested that the paragraph be re-drafted to use the term "reasonable", which had already been used in a number of texts prepared by the Commission.

138. In response it was stated that "good faith" or an equivalent was necessary in the paragraph, since the receiving bank might have to use its judgment in a situation in which it had no individual advantage to be gained by varying from the instructions received. Its judgment should not later be questioned in such a situation.

139. Under another view a receiving bank that had accepted a payment order that contained instructions should be required to follow those instructions unless it was impossible to do so. Under yet another view the receiving bank should be permitted to use another funds transfer system or communications system under the conditions described in paragraph (5) but should be bound to use any intermediary bank specified by the sender. The reason given was that the sender was more apt to have reasons of its own, unknown to the receiving bank, for specifying an intermediary bank than for specifying a funds transfer system or communications system.

140. After discussion the Working Group decided to retain the paragraph and to refer the various drafting suggestions to the drafting group.

*Branches as banks*

141. The Working Group decided to adopt a new paragraph identical to article 9(4) to the effect that "A branch of a bank, even if located in the same State, is a separate bank for the purposes of this article." In support of adopting the new paragraph it was noted that a receiving bank might appropriately send its own payment order to another branch of the same bank. If the branches were not considered to be separate banks, the time limits in article 9 might be too short.

*Article 7*

142. Paragraphs (1), (2)(a) and (2)(b) were adopted with the changes made to article 5(1), (2)(a) and (2)(b). (See paragraphs 117, 123, 125 and 126, above.) Subparagraph (2)(c) was adopted without change.

143. It was suggested that, since subparagraphs (2)(d) to (2)(g) were all acts by which the beneficiary's bank placed the funds at the disposal of the beneficiary, such a formula might be used in subparagraph (2)(d) and the following subparagraphs might be deleted. It was stated that a danger of creating a list of means by which beneficiary's banks accepted payment orders was that some item might be left out that should have constituted an act of acceptance by the beneficiary's bank. Under another suggestion subparagraphs (2)(d) to (2)(g) might be integrated into article 8(4). In reply to the latter suggestion it was stated that article 7(2) provided for the occasions when the beneficiary's bank accepted a payment order while article 8(4) set out the obligations of a beneficiary's bank that had accepted the payment order.

144. A proposal was made to delete subparagraph (2)(e). It was said to serve a purpose only if the beneficiary's bank had not already credited the beneficiary's account, i.e. if the beneficiary had no account at the bank. In reply it was said that in precisely that situation, it was important that the beneficiary be notified that it had a right to withdraw the funds.

145. A proposal was made to add to subparagraph (2)(f) the words "or by the beneficiary". In opposition it was said that the originator might have designated transfer to a particular account of the beneficiary. It might not fulfil the underlying business arrangement between the originator and the beneficiary if the beneficiary was permitted to change the account to which the credit was to be made. If the beneficiary had the full right of disposition of the credit made to his account, which would be true in almost all cases, he would be able to transfer that amount by a new credit transfer.

146. It was suggested that the words "or applies it in conformity with an order of a court" in subparagraph (2)(g) should be deleted. It was said that it was unclear which courts might order the bank to apply the credit in some manner other than by credit to the account of the beneficiary, and especially whether the subparagraph re-



ferred to orders of foreign courts. In response it was said to be a provision that would do no harm and might help.

147. The Working Group decided to adopt subparagraphs (2)(d) to (2)(g) without change.

### Article 8

#### Paragraphs (1) to (3)

148. It was noted that paragraphs (1) and (2) did not state the time within which the receiving bank had to give the required notice and that the reference in paragraph (3) was incorrect. It was also noted that in the current draft there was no provision in article 9 on when notices had to be given. Those matters were referred to the drafting group.

149. It was stated that the Model Law should indicate what obligations the sender of a payment order had when he received the notice given by the receiving bank under paragraph (1), (2) or (3). In reply it was stated that any obligation of the sender would arise as a result of its also being a receiving bank that would have to give notice to its sender when the problem of which it had been notified was also in the payment order it had received. When the problem arose out of its own error, it should have an obligation under article 11 to aid the completion of the credit transfer by correcting its own payment order. After discussion the Working Group decided that no change should be made to the text.

150. Paragraphs (1) and (2) were adopted by the Working Group with the changes to be made to make them conform to the equivalent paragraphs in article 6. Paragraph (3) was adopted without change, except for the correction of the cross-reference.

#### Paragraph (4)

151. The Working Group discussed whether it should adopt the approach taken by Variant A or by Variant B. In favour of Variant A it was said that it more closely conformed to the general policy decisions taken by the Working Group that the Model Law should set forth the rights and obligations of the parties up to the moment when the beneficiary's bank accepted the payment order but that the Model Law should not enter into the relationship between the beneficiary and the beneficiary's bank. That policy was based on the consideration that the rights of the originator and of the various banks in the credit transfer chain through the bank that issued the payment order to the beneficiary's bank were adequately protected by the Model Law. Those were the only issues that needed to be treated by an international effort for the unification of law on a global scale. Since the law governing the account relationship between the beneficiary and the beneficiary's bank differed significantly from country to country, it would be particularly difficult to reach agreement on a uniform text. If agreement were to be reached in the Working Group on the obligations of the beneficiary's bank to the beneficiary, those obligations would apply only in respect of international credit transfers and not of other credit transfers.

152. In favour of Variant B it was stated that the credit transfer came to an end only when the beneficiary had effective use of the funds. It was appropriate for the Model Law to state the rules that governed the transfer to that point. It was also stated that one of the events that had led to the preparation of the Model Law had been a widely known case in which an originator had suffered a serious loss because the law governing the account relationship between the beneficiary and the beneficiary's bank was different from the law applicable to the underlying contract. In reply it was noted that the issue in that case had been the point of time when the credit transfer discharged the underlying obligation. That was said to be a problem governed by article 14 and not by article 8(4).

153. After discussion the Working Group decided to adopt Variant A in principle and to consider whether it should be amended in any manner.

154. It was stated that article 8(4) should be in conformity with article 7(2), and especially subparagraphs (d) through (g). It was suggested that that could be most easily accomplished by incorporating those provisions into article 8(4). In reply it was stated that article 7 and 8 were directed to two different questions. Article 7 dealt with the acceptance of the payment order by the beneficiary's bank while article 8 dealt with the obligations of the beneficiary's bank. Moreover, it was said, incorporating those subparagraphs of article 7(2) into article 8(4) would be the equivalent of reintroducing Variant B, which had already been rejected by the Working Group.

155. Another suggestion was that article 8(4) should specify that if the beneficiary's bank had accepted the payment order passively, it would have to place the funds at the disposal of the beneficiary; only if the beneficiary's bank had accepted the payment order by one of the explicit acts set out in article 7(2)(d) to (g) would it be required to give notice to the beneficiary of the acceptance.

156. The question was raised whether a beneficiary's bank would have fulfilled its obligation "to place the funds at the disposal of the beneficiary" if it had accepted the payment order under article 7(2)(g) by applying the credit to a debt of the beneficiary owed to it or by applying the credit in conformity with an order of a court. A similar question that was raised was whether a bank that netted outgoing payments against incoming credits placed the funds at the disposal of the beneficiary. It was suggested that some other formula might be used in article 8(4) such as "to give the beneficiary the benefit of the credit", or "to apply the funds in any way permitted by law".

157. The Working Group was agreed that the current formula was intended to cover the situation where the bank had netted obligations or had taken one of the actions described in article 7(2)(g). If under the circumstances the bank was found not to have acted properly when it applied the credit, that problem would be resolved under the otherwise applicable legal rules, but the payment order would, nevertheless, have been accepted under article 7(2)(g).

158. The Working Group discussed whether it was appropriate to refer to the applicable law governing the relationship between the bank and the beneficiary. The question was raised whether there might be a difference in the applicable law when the beneficiary had a contractual relationship with the beneficiary's bank and when it did not. A suggestion was made that reference should also be made to the agreement between the beneficiary and the beneficiary's bank.

159. After discussion the Working Group decided that it would not amend Variant A.

#### *Beneficiary's right to reject credit transfer*

160. A proposal was made that the Model Law should provide that the beneficiary would have a right to reject a credit transfer made to his account. It was stated that it was only logical that if the beneficiary's bank had a right to reject the payment order, the beneficiary should have a similar right. It was noted that if the beneficiary had a right to reject a credit transfer, it would normally be necessary that the return of the funds to the originator would be accomplished by a new credit transfer. It was noted that a similar situation existed when a beneficiary's bank rejected a payment order for any reason other than non-receipt of funds, since a new credit transfer was necessary to return the funds in that case as well. It was said that the discussion of the beneficiary's legal right to reject the credit transfer was a separate issue from the question as to how the funds would be returned, or at whose expense. It was also noted that, if a beneficiary exercised a right to reject a credit transfer, a convenient method of dealing with the funds without raising the problems of returning them would be to substitute the originator for the beneficiary with respect to the rights to the deposit that the beneficiary had rejected.

161. It was agreed that the right of the beneficiary to reject a credit transfer was related to the general issue of the completion of the credit transfer. It was pointed out that when the Working Group had adopted the definition of "credit transfer", it had placed the third sentence in square brackets as an indication that the substance of a rule as to when a credit transfer was completed was not being decided at that time. In that respect it was said that the right of the beneficiary to reject a credit transfer prior to its acceptance by the beneficiary's bank and his right to reject the credit transfer after acceptance by the beneficiary's bank should be distinguished.

162. It was stated that the Model Law might provide that the beneficiary had a right to reject the credit transfer if the transfer was for the purpose of discharging an obligation but the transfer did not conform to the authorized means of discharging that obligation. It was also stated that it was difficult to admit that the beneficiary could reject a credit transfer if the originator was authorized to pay the beneficiary in that manner. The reason the beneficiary wished to reject the transfer might be that he did not wish to have credit with the beneficiary's bank, perhaps because of questions that had arisen in respect of the solvency of the bank or because of the expectation of the imposition of exchange controls in the country where the

bank was located that would make it difficult for the beneficiary to use the funds.

163. It was pointed out that in some countries foreign remittances had to be converted in whole or in part into the local currency, which might not be freely convertible. In such a case it would be difficult to admit that the beneficiary would have a right to reject the credit transfer.

164. After discussion the Working Group decided that in principle the Model Law should provide that the beneficiary would have a right to reject the credit transfer. One of the participants was requested to prepare a draft provision for consideration by the Working Group at its next session, and to deal with the time within which the beneficiary would be permitted to act and the costs of any credit transfer returning the funds.

#### *Notice to beneficiary of credit*

165. It was proposed that the Model Law should provide that the beneficiary's bank was required to give the beneficiary notice of the credit. In response to the statement that the Working Group had decided not to enter into the relationship between the beneficiary and the beneficiary's bank, it was said that the duty of notification was owed to the sender and not to the beneficiary. Therefore, it would be within the proper scope of the Model Law to set forth that duty. Moreover, it was said, the originator had an interest that the beneficiary know that the credit had been received. Furthermore, since it had been decided that the beneficiary should have a right to reject the credit transfer, it was necessary that he be notified of the credit.

166. After discussion it was decided that any duty to notify a beneficiary who had an account with the beneficiary's bank could be left to their agreement or to the law applicable to the account relationship. It was also decided that the Model Law should provide that the beneficiary's bank would have to give notice to a beneficiary who did not maintain an account at the bank that it was holding funds for his benefit, provided that the bank had sufficient information to give such notice.

#### *Obligation to make funds available on pay date*

167. The Working Group considered, but did not decide, the issue of whether the beneficiary's bank should have a duty either to its sender or to the originator to make funds available on a pay date specified on the payment order.

#### *Article 9*

168. The question was raised whether it would be useful to have a specific rule in the Model Law that a sender would retain the right to revoke the payment order until the execution date when the receiving bank had accepted the order prior to the execution date. It was said that such a rule would have its most important effects in cases of insolvency.

169. The Working Group decided to keep the issue in mind in its consideration of articles 10 and 12.

170. The Working Group decided that the substance of the prior article 7(2), i.e. that a bank that received a payment order late complied with its obligations if it executed the order on the day received, was currently covered in the *chapeau* of article 9 where it was stated that a receiving bank was required to execute the payment order on the day it was received.

171. The Working Group referred to the drafting group the various drafting suggestions contained in A/CN.9/WG.IV/WP.44, comments 15 to 19 to article 9.

172. The Working Group adopted the proposal that notices required to be given by articles 6 and 8, should be given on the day the payment order was received. It was noted that such a rule might not be appropriate for the notice to be given to a beneficiary who did not maintain an account at the beneficiary's bank that the bank was holding funds for his benefit (see paragraphs 165 and 166, above). The drafting group was requested to consider how the safeguards in article 9(2) and (3) were to be dealt with.

173. It was noted that during the discussion of conditional payment orders it had been decided that the Working Group would have to consider the time available to the receiving bank to accept or reject the order before the bank would be considered to have accepted the order under article 5(2)(a) or 7(2)(a). One suggestion was that the bank be given a "reasonable" time. Another suggestion was that the receiving bank never be deemed to have accepted the payment order under those two subparagraphs; it would have obligations under the Model Law only if it accepted the payment order by one of the other means specified in those articles. Yet another suggestion was that the receiving bank should have no obligation to accept or reject the payment order until it knew that the condition had been fulfilled. It was suggested that the proper result would be reached by interpretation of the term "execution date".

174. After discussion the Working Group decided to defer the question to its next session.

175. The Working Group decided that articles 5(2)(a) and 7(2)(a) should provide that there should not be acceptance under those subparagraphs until the receiving bank had received payment from the sender in accordance with article 4(4). It referred to the drafting group the task of making the appropriate amendments. In explanation it was said that that rule would require the receiving bank to act once it had received funds, even though those funds had arrived late. It would also protect the receiving bank when the payment order contained a value date since the sender knew that the receiving bank would not have funds before that date. (For the earlier decision that acceptance would not take place under those subparagraphs if the reason for the failure to execute the payment order had been insufficient funds, see paragraphs 123 and 142, above.)

176. A proposal was made to relax the rule in the *chapeau* of paragraph (1), i.e. that a receiving bank was required to execute the payment order on the day it was

received, to permit execution on the following day. In support of the proposal it was said that a same-day rule was excessively strict for those occasions when the bank might receive an unusual number of payment orders. It was also said to be too strict for those countries whose banking systems were not sufficiently efficient to meet such strict requirements.

177. In opposition to the proposal it was said that the majority of international credit transfers were transmitted computer-to-computer and that same day execution should be the expected norm. It was also pointed out that paragraph (2) anticipated that banks would set cut-off times during the day for different types of payment orders, and that a payment order received after the cut-off time would be considered as having been received the following day. Since some banks set cut-off times as early as eight or nine in the morning for same-day processing of payment orders, the same-day rule in fact permitted banks to take up to two days.

178. There was some discussion as to whether the cut-off time was established unilaterally by the receiving bank or whether it was a system rule. It was pointed out that paragraph (2) provided that the cut-off time was established by the receiving bank. However, the bank might establish its cut-off time for certain types of payment orders by virtue of a system rule as to when the system would accept the orders. It was suggested that the concept of a cut-off time be clarified to emphasize that it might be fixed entirely at the discretion of the individual bank.

179. It was suggested that the term "day" should be defined to mean "working day". Another suggestion was that the period of time should be made more precise by specifying it in hours and not in days. It was also suggested that different periods of time might be appropriate for different types of payment orders, with a longer period of time for paper-based payment orders than for computer-to-computer payment orders.

180. It was suggested that the sender and the receiving bank should be able to derogate from the provisions of paragraph (1) by agreement. The possibility of derogation would establish the same-day rule as the general norm but would provide the necessary flexibility. In opposition it was stated that such a possibility would make it impossible for originator's banks to predict how long it would take for international credit transfers to take when they had to go through several intermediary banks.

181. After discussion the Working Group decided to adopt the *chapeau* of paragraph (1) without change.

182. In the context of subparagraph (1)(a) it was stated that the definition of "execution date" needed to be reconsidered. Similarly, the definition of "pay date" and subparagraph (1)(b) needed to conform. Various drafting suggestions were referred to the drafting group.

183. Paragraphs (2), (3) and (4) were adopted.

### Article 10

184. A proposal was made to replace the text of article 10 by the following:

*"Article 10. Payment orders not revokable*

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

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

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

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

185. In support of the proposal it was stated that the current text of article 10 was too intrusive and too complicated. There was no effective way to simplify its procedures by amendment of the current text, since the amendments would make the text itself more complicated. The proposed text was much simpler and it relieved receiving banks of the possibility that they would be liable to the originator or the sender if they failed to act upon the revocation order properly or that they might be liable to the beneficiary for interfering with any rights he might have under a theory of acquired rights. The sponsor of the proposal acknowledged that the proposal might not be complete in that it did not consider the question of the revocation of a payment order prior to a future execution date stipulated in the payment order. However, the proposal had been submitted with a view to offering an alternative approach for consideration at the next session of the Working Group.

186. The Working Group took note of the proposal and decided to examine it at its next session together with the proposal addressing the same issue that had originally been submitted to the nineteenth session, and which was reproduced in A/CN.9/WG.IV/WP.44, comment 16 to article 10.

### Article 12

187. At the commencement of the session a small group consisting of the delegates of France, the United Kingdom and the United States and the observer from Finland had been asked to consider the liability provisions in general and to attempt to formulate an agreed position that might be considered by the Working Group. The group reported that they had been unable to reach an agreed position. In order to facilitate the work of the Working Group they had identified four major issues and they submitted their separate views for the consideration of the Working Group. The views of France, the United Kingdom and the

United States were phrased in the form of answers to the questions they had posed. The views of Finland were phrased in the form of a new draft of a portion of article 11 and a re-drafting of article 12. While the four delegations submitted their views in writing to the Bureau and the Secretariat, they were presented orally to the Working Group.

188. The questions posed by the four delegations and a shortened form of their responses are as follows:

1. Should the "interest" provided for in article 12(5)(a) be at a specified rate?

France, the United Kingdom and the United States answered no. The draft text of Finland offered two possible rules for determining the rate, including the rate as established by the law applicable to the obligations of the receiving bank that caused the delay or the inter-bank lending rate at that place.

2. Should a "loss caused by a change in exchange rates" (article 12(5)(b)) be included as an ingredient of damages?

France and the United States answered no. France explained that the loss could arise only if the money of the transfer was not that of the place of the beneficiary. In that case the beneficiary would have accepted the risk of changes in exchange rates. Furthermore, if exchange losses were to be considered, exchange gains during the delay should also be considered.

Finland and the United Kingdom answered yes. The draft text submitted by Finland provided for liability when the credit transfer was in a currency other than the currency of the place where the beneficiary's bank was located.

3. Should "any other loss that may have occurred as a result" (article 12(5)(d)) be included as an ingredient of damages?

Finland answered yes, if the loss was due to non-completion or late completion of a credit transfer that was caused by a person employed or otherwise engaged by the receiving bank in the course of his duties relating to the execution of payment orders for the receiving bank and with the intent to cause loss or with gross disregard as to the risk of loss.

France answered yes, if the losses were foreseeable.

The United Kingdom answered that it was broadly content with the current provision but it offered a revision of the text.

The United States answered no.

4. To whom, and by whom, should damages be paid?

The answers were too complex to summarize. In general, the responsibility was thought to be that of the bank where the loss occurred. Finland, France, the United Kingdom and the United States said they believed the beneficiary should have a direct right to recover interest for delay. Finland proposed that the beneficiary should be entitled to claim the interest either from the bank that caused the delay or from the beneficiary's bank, which would have a right of recourse backward in the credit transfer chain.

### Article 14

189. The Working Group engaged in a short general discussion of article 14 so as to lay a foundation for a more thorough discussion at the next session of the Working Group.

190. Although there was some support for the retention of paragraph (1), the general view was that it was not acceptable. It attempted to state a rule that might be generally followed in practice, but that violated deeply held feelings about the appropriate legal rules on the subject.

191. There was more general support for the inclusion in the Model Law of some rule that would have the effect of determining when an underlying obligation would be discharged. There was general agreement that paragraph (2) as currently drafted was unacceptable. Some support was expressed for the alternative proposals set out in A/CN.9/WG.IV/WP.44, comments 7 and 8. The view was also expressed that the proposal in comment 7 would be unacceptable as a matter of legislative policy because of the very fact that it set out a rule for the discharge of obligations.

192. The Secretary requested delegations to propose alternative texts for an article 14 that would fulfil the needs of the Model Law for a rule on the effect of a completed credit transfer without raising the kinds of concerns that delegates had expressed in rejecting the current draft. Suggestions should be sent to the Secretary by the beginning of March, 1990 for inclusion in the working paper for the next session.

#### Drafting group

193. A drafting group was created to review the text of the articles considered by the Working Group at the current session. The drafting group was asked to consider the drafting proposals that had been made during the course of the session of the Working Group, to align the presentation of the various provisions for consistency and to assure concordance of the different language versions.

194. Articles 1 to 9 of the text of the draft Model Law set out in the annex to this report are as revised by the drafting group. Articles 10 to 15 were not revised and are as set out in the report of the nineteenth session of the Working Group, A/CN.9/328, annex. The only reservation that was expressed to the proposed draft concerned the criteria of internationality. The Working Group noted that the drafting group appeared not to have correctly implemented the idea expressed in paragraph 23, above.

#### Statement by the delegation of the United States

195. At the close of the session the delegation of the United States stated that it had great concern for the direction the Model Law project had taken and for the product it seemed destined to produce. When the effort began there was the potential to produce a single law that, across the world, would govern high speed electronic funds transfers. The United States had completed the preparation of its own version of such a statute, Article 4A of the Uniform Commercial Code. The differences be-

tween the two laws made it virtually inconceivable that the United States would adopt both.

196. The delegation said that it thought that Article 4A was a better law than the current Model Law. It was written with a greater appreciation of commercial reality. It relied upon the advice and guidance of those intimately involved with the workings of electronic funds transfers more than did these deliberations. It was less wedded than was the UNCITRAL Model Law to the traditions of the past.

197. The delegation suggested that one possibility was to separate the Model Law into two parts—one applicable to modern, high-speed electronic systems and another applicable to slower systems that were paper-related and more consistent with legal traditions of the past.

198. In response, it was stated that the Model Law project endeavoured to integrate the experience and objectives of all participating States to establish minimum standards that would assist in the development of international credit transfers and to reduce obstacles to international trade. It was noted that the law of many participating States had contained provisions dealing with credit transfers for many years and that considerable experience and jurisprudence existed with respect to them. In contrast, Article 4A was new and, as yet, untested. But the major role of United States' payment systems was also recognized. The hope was expressed that all States would continue to participate in the Model Law project not with a view to enshrining national law concepts, but with a view to reflecting them constructively in a useful new regime.

## II. FUTURE SESSIONS

199. The Working Group noted that the twenty-first session would be held in New York from 9 to 20 July 1990 and that the twenty-second session, if it was necessary, would be held in Vienna from 26 November to 7 December 1990.

### ANNEX

#### Draft Model Law on International Credit Transfers resulting from the twentieth session of the Working Group on International Payments\*

##### CHAPTER I. GENERAL PROVISIONS

###### Article 1. *Sphere of application\**

(1) This law applies to credit transfers where the originator's bank and the beneficiary's bank are in different States or, if the

\*At the twentieth session the Working Group considered and the drafting group revised articles 1 to 9. Articles 10 to 15 are presented as they were in A/CN.9/328, Annex.

\*This Model Law is subject to any legislation dealing with the rights and obligations of consumers.

originator is a bank, that bank and the beneficiary's bank are in different States.

(2) For the purpose of determining the sphere of application of this Law, branches of a bank in different States are considered to be separate banks.

#### Article 2. Definitions

For the purposes of this law:

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

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

(i) the instruction contains no conditions other than conditions imposed by the originator that are to be satisfied on or before the issue of a payment order by the originator's bank,

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

(iii) the instruction is to be transmitted either directly to the receiving bank, or to an intermediary, a funds transfer system, or a communication system for transmittal to the receiving bank, and

(iv) the instruction is not intended to establish a letter of credit.

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

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

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

(f) "Bank" means an entity which, as an ordinary part of its business, engages in executing payment orders [and moving funds to other persons].

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

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

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

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

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

(l) "Pay date" means the date specified by the originator when funds are to be placed at the disposal of the beneficiary.

#### Article 3. Deleted

## CHAPTER II. DUTIES OF THE PARTIES

### Article 4. Obligations of sender

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

(2) Notwithstanding anything to the contrary in paragraph (1) of this article, when a payment order is subject to authentication, a purported sender of such an order is bound if:

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

(b) the amount of the order is covered by a withdrawable credit balance or authorized overdraft in an appropriate account of the sender with the receiving bank or there is an agreement between the sender and the receiving bank that such payment orders may be executed despite the absence of such balances or overdrafts, and

(c) the receiving bank complied with the authentication.

#### (3) Variant A

A purported sender [that is not a bank] is, however, not bound by a payment order under paragraph (2) of this article if

(a) the actual sender was a person other than a present or former employee of the purported sender, and

(b) the actual sender had gained access to the authentication procedure without fault on the part of the purported sender.

#### Variant B

No sender may become bound under paragraph (2) of this article if the sender proves that the payment order was executed by

(a) a present or former employee or agent of the receiving bank, or

(b) a person acting in concert with a person described in subparagraph (a), or

(c) any other person who, without the sender's authorization, obtained confidential information about the authentication from a source controlled by the receiving bank, regardless of fault.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

*Article 7. Acceptance or rejection by beneficiary's bank*

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

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

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

(c) when it notifies the sender of acceptance,

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

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

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

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

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

*Article 8. Obligations of beneficiary's bank*

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

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

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

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

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

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

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

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

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

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

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

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

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

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

#### Article 10. *Revocation*

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

- (a) it was issued by the sender of the payment order,
- (b) it was received in sufficient time before the execution of the payment order to enable the receiving bank, if it acts as promptly as possible under the circumstances, to cancel the execution of the payment order, and
- (c) it was authenticated in the same manner as the payment order.

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

- (a) it was issued by the sender of the payment order,
- (b) it was received in sufficient time before acceptance of the payment order to enable the beneficiary's bank, if it acts as promptly as possible under the circumstances, to refrain from accepting the payment order, and
- (c) it was authenticated in the same manner as the payment order.

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

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

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

- (a) if, as a result of the revocation, the credit transfer is not completed, or
- (b) if, in spite of the revocation, the credit transfer has been completed due to a failure of the receiving bank or a subsequent receiving bank to comply with its obligations under paragraphs (1), (2) or (4).

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

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

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

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

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

#### Article 11. *[Assistance and refund]*

A receiving bank other than the beneficiary's bank that accepts a payment order is obligated under that order:

(a) where a payment order is issued to a beneficiary's bank in an amount less than the amount in the payment order issued by the originator to the originator's bank—to assist the originator and each subsequent sending bank, and to seek the assistance of its receiving bank, to obtain the issuance of a payment order to the beneficiary's bank for the difference between the amount paid to the beneficiary's bank and the amount stated in the payment order issued by the originator to the originator's bank.

(b) where a payment order consistent with the contents of the payment order issued by the originator and containing instructions necessary to implement the credit transfer in an appropriate manner is not issued to or accepted by the beneficiary's bank—to refund to its sender any funds received from its sender, and the receiving bank is entitled to the return of any funds it has paid to its receiving bank.

#### Article 12. *Liability and damages*

[(1) A receiving bank that fails in its obligations under article 5 is liable therefor to its sender and to the originator.]

(2) The originator's bank and each intermediary bank that accepts a payment order is liable to its sender and to the originator for the losses as set out in paragraph (5) of this article caused by the non-execution or the improper execution of the credit transfer as instructed in the originator's payment order. The credit transfer is properly executed if a payment order consistent with the payment order issued by the originator is accepted by the beneficiary's bank within the time required by article 9.

(3) An intermediary bank is not liable under paragraph (2) if the payment order received by the beneficiary's bank was consistent with the payment order received by the intermediary bank and it executed the payment order received by it within the time required by article 9.

(4) The beneficiary's bank is liable

(a) to the beneficiary for its improper execution or its failure to execute a payment order it has accepted to the extent provided by the law governing the [account relationship] [relationship between the beneficiary and the bank], and

(b) to its sender and to the originator for any losses caused by the bank's failure to place the funds at the disposal of the beneficiary in accordance with the terms of a pay date or execution date stated in the order, as provided in article 9.

(5) If a bank is liable under this article to the originator or to its sender, it is obliged to compensate for

- (a) loss of interest,
- (b) loss caused by a change in exchange rates,
- (c) expenses incurred for a new payment order [and for reasonable costs of legal representation].\*

\*Consideration may be given to allowing recovery of reasonable costs of legal representation even if they are not recoverable under the law of civil procedure.



(d) [any other loss] that may have occurred as a result, if the improper [or late] execution or failure to execute [resulted from an act or omission of the bank done with the intent to cause such improper [or late] execution or failure to execute, or recklessly and with knowledge that such improper [or late] execution or failure to execute would probably result].

(6) If a receiving bank fails to notify the sender of a misdirected payment order as provided in articles 6(3) or 8(2), and the credit transfer is delayed, the receiving bank shall be liable:

(a) if there are funds available, for interest on the funds that are available for the time they are available to the receiving bank, or

(b) if there are no funds available, for interest on the amount of the payment order for an appropriate period of time, not to exceed 30 days.

(7) Banks may vary the provisions of this article by agreement to the extent that it increases or reduces the liability of the receiving bank to another bank and to the extent that the act or omission would not be described by paragraph (5)(d). A bank may agree to increase its liability to an originator that is not a bank but may not reduce its liability to such an originator.

(8) The remedies provided in this article do not depend upon the existence of a pre-existing relationship between the parties, whether contractual or otherwise. These remedies shall be exclusive and no other remedy arising out of other doctrines of law shall be available.

**Article 13. Exemptions**

A receiving bank and any bank to which the receiving bank is directly or indirectly liable under article 12 is exempt from liability for a failure to perform any of its obligations if the bank proves that the failure was due to the order of a court or to interruption of communication facilities or equipment failure, suspension of payments by another bank, war, emergency conditions or other circumstances that the bank could not reasonably be expected to have taken into account at the time of the credit transfer or if the bank proves that it could not reasonably have avoided the event or overcome it or its consequences.

**CHAPTER IV. CIVIL CONSEQUENCES OF CREDIT TRANSFER**

**Article 14. Payment and discharge of monetary obligations; obligation of bank to account holder**

(1) Unless otherwise agreed by the parties, payment of a monetary obligation may be made by a credit transfer to an account of the beneficiary in a bank.

(2) The obligation of the debtor is discharged and the beneficiary's bank is indebted to the beneficiary to the extent of the payment order received by the beneficiary's bank when the payment order is accepted by the beneficiary's bank.

(3) If one or more intermediary banks have deducted charges from the amount of the credit transfer, the obligation is discharged by the amount of those charges in addition to the amount of the payment order as received by the beneficiary's bank. Unless otherwise agreed, the debtor is bound to compensate the creditor for the amount of those charges.

(4) To the extent that a receiving bank has a right of reimbursement from a sender by debit to an account held by the receiving bank for the sender, the account shall be deemed to be debited when the receiving bank accepts the payment order.

**CHAPTER V. CONFLICT OF LAWS**

**Article 15. Conflict of laws**

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

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

**E. International credit transfers: comments on the draft Model Law on International Credit Transfers: report of the Secretary-General<sup>a</sup>  
(A/CN.9/WG.IV/WP.44) [Original: English]**

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## INTRODUCTION

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

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

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

4. At its eighteenth session held at Vienna from 5 to 16 December 1988 the Working Group began its consideration of the redraft of the Model Rules prepared by the

Secretariat in A/CN.9/WG.IV/WP.39. It renamed the draft Model Rules as the draft Model Law on International Credit Transfers (A/CN.9/318). The Working Group continued its consideration of the draft provisions at its nineteenth session held in New York from 10 to 21 July 1989. During the session a drafting group prepared a restructured text of the draft Model Law for discussion at the twentieth session of the Working Group. The new text of the Model Law is contained in annex I to that report (A/CN.9/328, para. 145).

5. This report contains a commentary on the draft articles of the text as restructured by the drafting group at the nineteenth session, indicating their history and their relation to other provisions. In some places where the text was not considered at the nineteenth session, or was considered but not changed, the commentary may be identical to that in the report of the Secretary-General before the nineteenth session (A/CN.9/WG.IV/WP.41). The report also contains suggestions by the Secretariat as to changes that might be made in the text.

6. The comments to a number of the articles raise drafting or presentation problems of varying degrees of importance. In addition to those issues, which should be common to all language versions, problems of terminology and drafting exist within all of the individual language versions. Now that many of the basic policy decisions have been made in the Working Group, it is to be hoped that a drafting group can be constituted at the twentieth session to resolve many of those problems.

## COMMENTS ON THE DRAFT MODEL LAW ON INTERNATIONAL CREDIT TRANSFERS

### *Prior discussion*

A/CN.9/318, paras. 10 to 19

### *Comments*

1. The current title was adopted by the Working Group at its eighteenth session. The Working Group decided that the words "Model Law" should be used in the title to reflect the fact that the text was for use by national legislators and that the text should not for the time being be in the form of a convention (A/CN.9/318, paras. 12 and 13).
2. The use of the words "Credit Transfers" reflected the decision that only credit transfers and not debit transfers should be included (A/CN.9/318, para. 14). The decision is set forth as a rule in article 1(1). Credit transfers are defined in article 2(a).
3. The word "electronic" is not used in the title as a result of the decision that the Model Law would be applicable to paper-based credit transfers as well as to those made by electronic means (A/CN.9/318, paras. 15 to 17).
4. The Working Group decided that the Model Law should be restricted to international credit transfers and that that decision should be reflected in the title (A/CN.9/318, para. 18). The criteria for determining whether a credit transfer is international are to be found in article 1.

## CHAPTER I. GENERAL PROVISIONS

### Article 1. *Sphere of application\**

- (1) This law applies to credit transfers where the originator's bank and the beneficiary's bank are in different countries.
- (2) For the purpose of determining the sphere of application of this Law, branches of banks in different countries are considered to be separate banks.

### *Prior discussion*

A/CN.9/297, paras. 12 to 23 and 29 to 31  
 A/CN.9/317, paras. 16 to 24, 30 and 95 to 97  
 A/CN.9/318, paras. 20 to 34, 53 and 54  
 A/CN.9/WG.IV/WP.41, article 1, comments 16 and 18

### *Comments*

1. Article 1 was adopted in its current form by the Working Group at its eighteenth session (A/CN.9/318). It was not considered at the nineteenth session.

### *Internationality of a transfer*

2. As indicated by the title, the Model Law will apply only to credit transfers that are international. The test of

internationality in paragraph (1) is that the originator's bank and the beneficiary's bank are in different countries.

3. Since the application of the Law depends on the existence of two banks in different countries, normally the Law would not apply where the originator and the beneficiary had their accounts in the same bank. However, according to paragraph (2), for the purposes of the sphere of application of this Law, branches of banks in different countries are considered to be separate banks. Therefore, a transfer may be within the application of this Law even though only one bank is involved if the accounts are in branches of that bank in different countries. In order to eliminate a possible ambiguity, the text of paragraph (2) should refer to "branches of a bank" in different countries.

4. The rule that the Model Law does not apply where the originator and the beneficiary have their accounts in the same bank applies as well to a bank that effects a transfer for its own account. Such a bank is an originator. Although the term "originator's bank" is not defined, the logic of the words suggests that an originator's bank is the bank where the originator has its account. Therefore, a bank that is an originator cannot be at the same time the originator's bank. Similarly a bank that receives credit for its own account is a beneficiary and not a beneficiary's bank.

5. Therefore, a credit transfer by Bank A as an originator to Bank B as the beneficiary made by instructing their mutual correspondent Bank C to debit and credit the appropriate accounts held with it is not an international credit transfer and the Model Law would not apply even if the three banks were in different States.

6. If the transfer in the example above was to Bank B for the credit of its customer, Bank C would be the originator's bank and Bank B would be the beneficiary's bank. The transfer would be international if Bank B and Bank C were in different States.

7. If it is considered desirable for the Model Law to apply whenever two banks are involved in different States, consideration could be given to introducing a definition of originator's bank as "(1) the receiving bank to which the payment order of the originator is issued if the originator is not a bank or (2) the originator if the originator is a bank" with a similar definition of "beneficiary's bank". If this suggestion is adopted, the use of the term "originator's bank" would have to be reconsidered in articles 2(a), 2(g), 8(3), 11(a) and 12(2). Similarly, the use of the term "beneficiary's bank" would have to be reconsidered.

8. In some cases involving a transfer from a customer's account in a financial institution in State A to an account in a financial institution in State B, application of this Law will depend on whether both financial institutions are considered to be banks under the definition of a bank in article 2(e). If either financial institution was determined not to be a bank because it did not as an ordinary part of its business engage in credit transfers for other persons, the other financial institution would be both the originator's bank and the beneficiary's bank and the Model Law would not apply. Such a situation might arise where one of the financial institutions was a broker which would, on

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

instructions of a customer, transfer a credit balance in a customer's brokerage account but which did not engage in credit transfers for its customers as an ordinary part of its business. See comments 12 and 13 to article 2.

9. A determination as to whether a credit transfer was international would also depend on how the transfer was structured. An example was given in the eighteenth session of the Working Group where the originator's bank in State A reimbursed the beneficiary's bank in State B by several different means. It was stated that those different means of reimbursing the beneficiary's bank for the transfer would determine whether some or all of the activities comprising the transfer would be considered to be international and fall within the sphere of application of the Model Law or would be considered to be domestic and fall outside of it (A/CN.9/318, paras. 25 to 26). It was said in the Working Group that that result was not appropriate since the transfer would otherwise be identical from an economic point of view. Although the definition of a credit transfer in article 2(a) as comprising "a complete movement of funds from the originator to the beneficiary" might lead to the result that the Model Law would apply to all elements of a credit transfer that was international under article 1, the provision on the territorial application of the Model Law might lead to a different result. See comment 12, below.

10. International credit transfers may be denominated in the currency of the country where the originator's bank is located, in the currency of the country where the beneficiary's bank is located, or in some other currency or unit of account. If the originator's bank and the beneficiary's bank were in the same country, the Model Law would not apply to the transfer even if it was denominated in the currency of a third country. That result was adopted because, while the settlement between the originator's bank and the beneficiary's bank might have to pass through banks in the country of the currency in which the transfer was denominated, it might also be possible for settlement to be effected within the country where the two banks were located (A/CN.9/318, para. 21).

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

12. Since the Model Law is being prepared for international credit transfers, questions of conflict of laws naturally arise. Draft provisions on the territorial application of the Model Law are contained in article 15. Further consideration was given to the question in a report that was prepared for the nineteenth session of the Working Group, A/CN.9/WG.IV/WP.42, paras. 69 to 80.

### *Consumer transfers*

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

14. At the same time, it was recognized that the special consumer protection legislation that exists in some countries, and that may be adopted in others, could be expected to affect some international credit transfers as well as domestic credit transfers. To accommodate that possibility, the footnote to article 1 was adopted to indicate that the Model Law would be subject to any national legislation dealing with the rights and obligations of consumers, whether the provisions of that legislation supplemented or contradicted the provisions of the Model Law (A/CN.9/318, paras. 30 to 33).

### *Effect of contractual agreement*

15. At its eighteenth session the Working Group decided that the extent to which the Model Law would be subject to the agreement of the interested parties would be considered in connection with the individual provisions (A/CN.9/318, para. 34). In the current draft mention of the effect of contractual rules is made in articles 4(2)(b), 5(2)(b), 7(2)(b), 8(2), 8(4)(a) Variant B, 12(7), 14(1), 14(3), 15(1) and 15(2).

### *Article 2. Definitions*

(a) "Credit transfer" means a complete movement of funds from the originator to the beneficiary pursuant to a payment order received by the originator's bank [directly] from the originator. A credit transfer may involve one or more payment orders.

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

(c) "Beneficiary" means the ultimate person intended to receive the funds as a result of a credit transfer.

(d) "Sender" means the person who sends a payment order including the originator and any sending bank.

(e) "Bank" means a financial institution which, as an ordinary part of its business, engages in credit transfers for other persons.

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

(g) "Intermediary bank" means any bank executing a payment order other than the originator's bank and the beneficiary's bank.

(h) "Funds" or "money" includes credit in an account kept by a bank and includes credit denominated in a monetary unit of account that is established by an inter-

governmental institution or by agreement of two or more States, provided that this Law shall apply without prejudice to the rules of the intergovernmental institution or the stipulations of the agreement.

(i) "Payment order" means a message, whether written or oral, that contains an order to the receiving bank to pay, or to cause another bank to pay, to a designated person a fixed or determinable amount of money.

(j) "Authentication" means a procedure to determine whether all or part of a payment order is authorized, and which is the product of an agreement.

(k) "Cover" means the provision of funds to a bank to reimburse it for a payment order sent to it. The provision of cover might precede or follow execution of the order by the receiving bank.

(l) "Execution date" means the date when the receiving bank is to execute the payment order, as specified by the sender. When no execution date is stated on a payment order, the execution date of that order shall be deemed to be the date the order is received, unless the nature of the order indicates that a different execution date is appropriate.

(m) "Pay date" means the date when funds are to be at the disposal of the beneficiary, as specified by the originator.

(n) "Value date" means the date when funds are to be at the disposal of the receiving bank.

#### *Prior discussion*

A/CN.9/297, paras. 24 to 28

A/CN.9/317, paras. 26 to 47

A/CN.9/318, paras. 35 to 59, 75, 76, 94 and 106

A/CN.9/328, paras. 79 and 88

#### *Comments*

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

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

#### *Chapeau*

3. It may be useful to introduce article 2 with the words "For the purposes of this law", especially since some of the terms such as "bank" may be defined in other ways in the statutory law of a State that adopts the Model Law.

#### *"Credit transfer"*

4. The definition is based upon the definition of "funds transfer" in ISO 7982-1. The words "pursuant to a payment order received by the originator's bank [directly] from the originator" were added by the Working Group at its eighteenth session as a means of clarifying the difference between a credit transfer and a debit transfer (A/CN.9/318, para. 36). The word "directly" was placed in square brackets because of a concern that it might exclude some types of transfers that should be considered to be credit transfers.

5. At the eighteenth session of the Working Group concern was expressed about the use of the words "complete movement of funds" (A/CN.9/318, para. 37). The words form part of the ISO definition and no special examination was given to them by the Working Group. They would seem to indicate that the term "credit transfer" includes the entire set of actions from the issue of the payment order by the originator through credit to the account of the beneficiary, or other action leading to completion of the transfer. These words also indicate that reimbursement of the beneficiary's bank and any intermediary banks is part of the transfer. Potentially, therefore, the words have an important effect on the sphere of application of the Model Law. See comment 9 to article 1.

6. The second sentence refers to "one or more payment orders" rather than to one or more "funds transfer transactions" as in ISO 7982-1 or to one or more "segments", as in the draft before the Working Group at its eighteenth session. While the change in wording gives a narrower focus to the sentence, it would not seem to narrow the practical effect of the sentence.

7. Although the definition as derived from ISO 7982-1 probably does not cause any confusion, the concerns expressed at the eighteenth session may lead to its further precision. Consideration might be given to defining a credit transfer as consisting "of a series of actions commencing with issue of the originator's payment order, taken for the purpose of transferring funds to the beneficiary." It may be thought not to be necessary to include a reference to the existence of one or more payment orders, as in the current definition. While a credit transfer in general may involve only one payment order, an international credit transfer subject to the Model Law requires the existence of at least two payment orders, one from the originator to the originator's bank and a second from the originator's bank to the beneficiary's bank in another country. The proposed definition would mark the beginning of the credit transfer as being the issue of a payment order by the originator. While the credit transfer is completed by acceptance of an appropriate payment order by the beneficiary's bank, it may not be necessary for the definition to so indicate. Compare article 14, comment 8.

#### *"Originator"*

8. The definition differs from the wording of the definition in ISO 7982-1, but not from its meaning. It was approved by the Working Group at its seventeenth and eighteenth sessions (A/CN.9/317, para. 32; A/CN.9/318, para. 41). Under the definition a bank that issues a pay-

ment order for its own account is an originator. See comments 4 to 7 to article 1 for the consequences of the sphere of application of the Model Law and for a suggestion as to a definition of "originator's bank" and of "beneficiary's bank".

#### *"Beneficiary"*

9. The definition differs from the wording of ISO 7982-1 in that a person whose account is credited in error is not a beneficiary (A/CN.9/318, para. 42). Although it is not stated in the definition, it would seem that the person intended to receive the funds is the person named as beneficiary in the originator's payment order. For the situation where the identity of the beneficiary is expressed both by words and by account number and there is a discrepancy between them, see article 8(3). Similarly to the rule in regard to an originator, a bank may be the beneficiary of a transfer.

#### *"Sender"*

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

#### *"Bank"*

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

12. The definition in ISO 7982-1 is that a bank is "a depository financial institution". The Working Group was of the view that the test as to whether a financial institution should have the rights and obligations of a bank under the Model Law should depend on whether "as an ordinary part of its business it engaged in credit transfers for others", rather than whether it engaged in the totally unrelated activity of taking deposits. As a result, some individual financial institutions that would not normally be considered to be banks, such as dealers in securities that engage in credit transfers for their customers as an ordinary part of their business, would be considered to be banks for the purposes of the Model Law.

13. The extension of the definition to such financial institutions has the potential to extend the sphere of application of the Model Law. If a given brokerage firm met the definition of a bank, it would be either an originator's bank or a beneficiary's bank (since it can be assumed that such institutions would not function as intermediary banks), and the payment orders given to it by its customer would be governed by this Law rather than by some other body of law. If another brokerage firm was not

considered to be a bank under the definition, its payment order to a bank to make a transfer would be as an originator, even if in the given case the order was given for the account of one of its customers. The order from the customer to the brokerage firm would be outside the sphere of application of the Model Law. Compare comment 8 to article 1.

14. An earlier version of the draft Model Law provided that "for the purposes of these Rules a branch of a bank is considered to be a separate institution". At the eighteenth session of the Working Group the sentence was deleted and it was decided that consideration would be given in each of the substantive articles whether branches should be treated as banks (A/CN.9/318, para. 54). Paragraphs indicating that branches of a bank are considered as separate banks have been added to articles 1(2), 9(4) and 10(9) (A/CN.9/328, paras. 82 and 110).

#### *"Receiving bank"*

15. Although the Working Group at its eighteenth session modified the wording of the definition from that found in ISO 7982-1, the meaning remained the same (A/CN.9/318, paras. 55 to 57). A bank that receives a payment order is a receiving bank even if the payment order was not addressed to it. (The problem of mis-directed payment orders is addressed in articles 6(2) and 8(1).) A bank to which a payment order is addressed but which does not receive it is not a receiving bank.

#### *"Intermediary bank"*

16. The definition was proposed by the Working Group at its seventeenth session (A/CN.9/317, para. 41). It differs from the definition in ISO 7982-1 in three substantial respects: first, it includes all banks other than the originator's bank and the beneficiary's bank, whereas ISO 7982-1 includes only those banks between the given receiving bank and the beneficiary's bank; secondly, ISO 7982-1 includes only those banks between the receiving bank and the beneficiary's bank "through which the transfer must pass if specified by the sending bank"; and thirdly, reimbursing banks are included in this definition, even though the transfer may be considered not to pass through them and they are not in the chain of payment orders from the originator to the beneficiary's bank.

#### *"Funds" or "money"*

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

#### *"Payment order"*

18. In accordance with a suggestion made at the seventeenth session of the Working Group, the minimum data elements necessary to constitute a payment order were included in the definition of the term submitted to the

eighteenth and nineteenth sessions (A/CN.9/317, para. 54). At the nineteenth session the drafting group separated the definition into two elements. The sentence as found in the current text became the definition. The requirements as to the minimum data elements in a payment order are set out in article 3.

19. Although there was some hesitancy at the seventeenth session of the Working Group as to whether it was necessary to specify that the payment order could be either written or oral (A/CN.9/317, para. 53), the words have been retained since they seem to add clarity to the definition. However, it may be preferable if the definition were to provide that the payment order could be "in any form", since it may be questionable whether a payment order in computer readable form is in written form.

#### "Authentication"

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

21. The definition makes it clear that an authentication of a payment order does not refer to formal authentication by notarial seal or the equivalent, as it might be understood in some legal systems. The definition also differs from the definition of "message authentication" in ISO 7982-1 in that authentication as here defined does not include the aspect of validating "part or all of the text" of a payment order. That may be appropriate, even though most authentication techniques that rely upon the use of computers do both, since this Model Law also applies to paper-based payment orders. However, a definition of authentication that included validation of part or all of the text might be desirable if it was thought desirable to extend the result of article 4(2) to the content of the payment order. See comment 10 to article 4. Moreover, the definition of "authentication" should extend to revocations of payment orders. See comment 6 to article 10.

22. The definition as adopted by the Working Group at its eighteenth session includes the provision that the authentication procedure is the product of an agreement (A/CN.9/318, paras. 75, 76 and 94). That agreement may be embodied in the rules of a clearing house or message system or it may be in the form of a bilateral agreement between the sender and the receiving bank. Under article 4(2) the authentication procedure must be "commercially reasonable" in order for a purported sender to be bound by an unauthorized payment order even if the authentication used was agreed to by the sender.

23. The Working Group may wish to consider modifying the definition as follows:

"'Authentication' means a procedure established by agreement to determine whether all or part of a payment order or a revocation of a payment order was issued by the purported sender or whether there has been an error in its transmission or in its content."

#### "Cover"

24. The first sentence has the same meaning, though not the same wording, as the definition of "cover payment" in ISO 7982-1. The second sentence was added at the suggestion of the Working Group at its seventeenth session (A/CN.9/317, para. 33).

25. Concern over use of the word "cover" has been expressed in the Working Group on several occasions. In the current draft the word is used in articles 4(2)(b) (different meaning), 5(2)(b) and 7(2)(b).

#### "Execution date"

26. There is no equivalent term in ISO 7982-1. The execution date is the date on which a given payment order is to be executed as specified by the sender. Since a credit transfer may require several payment orders, each of those payment orders may have an execution date, and each of the execution dates may be different.

27. At the eighteenth session of the Working Group the second sentence, which had been part of article 7(1)(b), was added to the definition (A/CN.9/318, paras. 104, 106). At the nineteenth session a proposal for a redrafting of article 7 (currently article 9), which was adopted in principle by the Working Group, would have deleted the second sentence of the definition (A/CN.9/328, para. 88). However, in the restructuring of the text by the drafting group, article 9 was modified substantially. As a consequence, the drafting group did not delete the second sentence of the definition pending further discussion of the text by the Working Group.

28. Since article 9(1)(a) provides that in the absence of a later execution date, the payment order must be executed on the day received, that aspect of the second sentence of the definition might be deleted. However, deletion of that portion of the second sentence would leave the definition of "execution date" restricted to the date specified by the sender, which might not be desirable. Depending on how the definition might be changed, consideration should be given as to whether that portion of the second sentence might be technically inconsistent with article 9(1)(b).

29. It would seem from the first sentence that the sender might specify the execution date either on the payment order or in a separate or standing instruction. The second sentence would seem to require the specification of the execution date by the sender to be on the payment order itself.

30. The current text of article 9 does not contain the element found in the second sentence of the definition of "execution date" that there may be something in the nature of the order to indicate that a date other than the date of receipt would be the appropriate execution date. That phrase, which was first added to the rule before the sphere of application of the Model Law was restricted to international credit transfers, can be easily applied to bulk credit transfers of low value sent through a system that operates on a set time schedule, such as execution on the third day after receipt of the payment orders on magnetic

tape. It may be less applicable to international credit transfers which are, at least at present, less likely to follow such a time schedule.

31. The current draft of the Model Law does not define what constitutes execution of the payment order by the receiving bank. When the bank is not the beneficiary's bank, execution of an order can be assumed to be the sending by the receiving bank of a payment order intended to carry out the order received (compare article 5(2)(d) with article 6(4)). When the receiving bank is the beneficiary's bank, execution is probably best understood as acceptance of the order in any of the ways specified in article 7(2). If the sender wishes to specify when the funds are to be placed at the disposal of the beneficiary, a "pay date" should be specified. The term "execute" in one of its various forms is used throughout the draft Model Law in connection with payment orders. In addition, in article 12(2) reference is made to execution of the credit transfer, and a definition is there given of that concept.

#### "Pay date"

32. The term "pay date" is also used by ISO 7982-1 to indicate the date when the funds are to be available to the beneficiary. ISO 7982-1 uses the term "payment date" to indicate the date on which a payment was executed. Such a term was included in the text before the seventeenth session of the Working Group but, since the term was not used further, it was deleted in the revision by the Secretariat submitted to the eighteenth session.

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

#### "Value date"

34. The definition is identical to that in ISO 7982-1. As in respect of "pay date", the question is left open as to when and under what circumstances the funds are at the disposal of the receiving bank.

35. In the discussions in the nineteenth session concerning article 7 (currently article 9), the Working Group agreed with the definition. It was suggested, however, that the value date only provided information to the receiving bank as to when it could expect to receive funds from the sender, but that it did not by itself establish any obligations since the receiving bank would have no obligation to accept the order or give notice of rejection until it had in fact received sufficient funds (A/CN.9/328, para. 79). In

the text as restructured by the drafting group, the term "value date" is not used and the definition might be deleted as unnecessary.

#### Article 3. Contents of payment order

A payment order is required to contain, either explicitly or implicitly, at least the following data:

- (i) identification of the sender;
- (ii) identification of the receiving bank;
- (iii) the amount of the transfer, including the currency or the unit of account;
- (iv) identification of the beneficiary;
- (v) identification of the beneficiary's bank.

#### Prior discussion

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

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

A/CN.9/WG.IV/WP.41, article 2, comment 18.

#### Comments

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

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

3. Authentication is not included as a required data element in a payment order. It is, however, defined in article 2(j). In accordance with the suggestion at the seventeenth session of the Working Group, the consequences of a failure to authenticate a payment order or other message are considered in article 4 on the obligations of a sender (A/CN.9/317, para. 55).

4. The fact that the required data elements could be contained in the payment order "either explicitly or implicitly" would also seem to make it clear that communicating parties can agree on specific formats, as was suggested in the Working Group (A/CN.9/317, para. 53). The designation of the currency or unit of account may be implicit where the credit transfer system used is restricted to a particular currency or unit of account.



5. A preliminary version of ISO Draft Proposal 7982-2, "Universal Set of Data Segments and Elements for Electronic Funds Transfer Messages" contained in document ISO/TC68/SC5/N230, dated 8 August 1988, proposes a set of mandatory data elements. Under the proposal, those mandatory data elements that would always be required to appear in the message are labelled "Mandatory Explicit". The data elements that would be required either to appear in the message or be derivable from another mandatory data segment and/or data element in the message or from the processing conventions of the system used are referred to in the proposal as "Mandatory Implicit". The document lists several data elements as being either mandatory explicit or mandatory implicit that are not set out in article 3, e.g. the date and time the message was delivered to a receiving bank by a communications service.

## CHAPTER II. DUTIES OF THE PARTIES

### Article 4. *Obligations of sender*

#### (1) *Variant A*

A purported sender is bound by a payment order, if he authorized it or if it was issued by a person who, pursuant to the applicable law [of agency], otherwise had the power to bind the purported sender by issuing the payment order.

#### *Variant B*

A purported sender is bound by a payment order if it was issued by the purported sender or by another person who had the authority to bind the purported sender.

(2) Notwithstanding anything to the contrary in paragraph (1), when a payment order is subject to authentication, a purported sender of such an order is bound if:

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

(b) the amount of the order is covered by a withdrawable credit balance or authorized overdraft in an appropriate account of the sender with the receiving bank or there is an agreement between the sender and the receiving bank that such payment orders are to be executed despite the absence of such balances or overdrafts, and

(c) the receiving bank complied with the authentication.

#### (3) *Variant A*

A purported sender [that is not a bank] is, however, not bound by a payment order under paragraph (2) if

(a) the actual sender was a person other than a present or former employee of the purported sender, and

(b) the actual sender had gained access to the authentication procedure without fault on the part of the purported sender.

#### *Variant B*

No sender may become bound under paragraph (2) if the sender proves that the payment order was executed by

(a) a present or former employee or agent of the receiving bank, or

(b) a person acting in concert with a person described in (a), or

(c) any other person who, without the sender's authorization, obtained confidential information about the authentication from a source controlled by the receiving bank, regardless of fault.

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

#### *Prior discussion*

A/CN.9/297, paras. 39 to 45 and 69

A/CN.9/317, paras. 57, 69 to 79 and 84

A/CN.9/318, paras. 70 to 109

#### *Comments*

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

#### *Paragraph (1)*

2. Paragraph (1) states the basic rule that a purported sender is bound by a properly authorized payment order. Concern was expressed at the eighteenth session of the Working Group to find a means to express the rule without referring to the law of agency so as not to be faced with the differences in legal systems on this issue. Variant B was proposed as a formulation to avoid that problem (A/CN.9/318, paras. 72, 73 and 83).

3. Paragraph (1) might be amended to make it applicable to the revocation of a payment order in accordance with the proposed modification of paragraph (2) suggested in comment 10, below.

#### *Paragraph (2)*

4. Paragraph (2) has been drafted as an exception to paragraph (1), but from the viewpoint of banking operations it provides the basic rule. In almost all cases a payment order must be authenticated. Proper authentication indicates proper authorization and the receiving bank will act on the payment order. Even if the payment order was not properly authorized under paragraph (1), the purported sender is bound by the order if the three requirements of paragraph (2) are met.

5. The first requirement is that the authentication provided is commercially reasonable. The discussion in the Working Group proceeded on the basis that it was the receiving bank that determined the type of authentication it was prepared to receive from the sender. Therefore, it

was the receiving bank's responsibility to assure that the authentication procedure was at least commercially reasonable. The sender and the receiving bank could not provide for a lower standard by agreement (A/CN.9/318, para. 75).

6. No attempt has been made to set a standard as to what constitutes a commercially reasonable authentication procedure. The standard would depend on factors related to the individual payment order, including such factors as whether the payment order was paper-based, oral, telex or data transfer, its amount and the identity of the purported sender. The standard as to what was commercially reasonable could be expected to change over time with the evolution of technology.

7. The second requirement, that the amount of the payment order is covered by a withdrawable credit balance or authorized overdraft in an appropriate account of the sender with the receiving bank, affords a protection for originators in some countries. By limiting the amount that can be debited to an account, a customer can limit the amount of potential loss. Such a limitation also furnishes to a limited degree an indication that an excessively large payment order may be in error or fraudulent.

8. The last clause was added to be sure that the provision would not cause problems in a net settlement system where a sending bank would have no account relationship with the receiving bank (A/CN.9/318, paras. 85 and 86). The clause would also seem to apply to the situation where a receiving bank was to receive reimbursement by credit in its account at a third bank. Furthermore, it was thought to apply to the situation in some countries where the agreements between banks and their customers provide that the bank is permitted, but not required, to create an overdraft when it receives a payment order from its customer (A/CN.9/318, paras. 84 and 86). However, the imperative nature of the words "are to be executed" may leave the latter case outside the clause as currently drafted.

9. The third requirement is that the receiving bank complied with the authentication. If the bank did not comply with the authentication but the payment order was authorized, the purported sender would be bound nevertheless under paragraph (1).

10. Difficulties were experienced at the nineteenth session in stating the authentication requirements of a revocation of a payment order (see article 10, comment 6). Those difficulties might be overcome, and authentication might be extended to the detection of errors in payment orders, by adopting the proposed new definition of "authentication" in article 2, comment 22, and by modifying paragraph (2) of this article as follows:

"Notwithstanding anything to the contrary in paragraph (1), when a payment order or a revocation of a payment order is subject to authentication, a purported sender of such an order is bound if:

(a) the authentication provided is a commercially reasonable method to determine whether all or part of

a payment order or a revocation of a payment order was issued by the purported sender or whether there was error in its transmission or in its content,

(b) ...

(c) ..."

#### *Paragraph (3)*

11. The paragraph was prepared in two versions at the eighteenth session of the Working Group. In general, those who were in favour of placing on the receiving bank the major risk that an authentication had been falsified by a known or unknown third person favoured variant A. That was said to be appropriate because it was the receiving bank that usually designed the authentication procedure (see comment 5, above). In general, those who were in favour of placing the major risk on the sender favoured variant B. That was said to be appropriate because it was the sender who chose the means of transmission of the particular payment order. Moreover, variant B would act as an incentive to senders to protect the authentication or encryption key in their possession (A/CN.9/318, paras. 88 to 90).

12. At the eighteenth session it was suggested that in order to compare better the advantages or disadvantages of the two variants, variant A should be re-written to state, as does variant B, what would have to be proven and by whom. Since even the supporters of variant A seemed to assume that it would be the sender who had the burden of proving the exonerating conditions (see A/CN.9/318, para. 91), the introductory words to variant A might read as follows:

"A purported sender [that is not a bank] is not bound under paragraph (2) if he proves that

(a) ...".

#### *Paragraph (4)*

13. The distinction between the obligation of the sender to pay the receiving bank being created when the receiving bank accepts the payment order and the obligation to pay maturing on the execution date is relevant when the execution date is in the future. At the eighteenth session the use of the execution date as the date when the sender should be obligated to make the funds available to the receiving bank was questioned on the grounds that the execution date was defined in article 2(1) as the date the receiving bank was obligated to act and not the date the receiving bank had performed its obligation (A/CN.9/318, para. 104).

14. It can be doubted whether receiving banks will often accept payment orders for future execution prior to the execution date, unless the sender has already paid for the order. However, if the receiving bank executes the payment order prior to the execution date, it accepts the order at the time of its execution. While the sender can no longer revoke the order (article 10(1) and (2)), and is obligated to pay for it, the receiving bank may not debit the sender's account or otherwise require payment for the order until the execution date. See, however, article 14(4).

**Article 5. Acceptance or rejection of a payment order by receiving bank other than a beneficiary's bank**

(1) If a receiving bank decides not to accept a sender's payment order, it is required to notify the sender of the rejection, unless one of the reasons is insufficient funds. A notice of rejection of a payment order must be given not later than on the execution date.

(2) A receiving bank that is not the beneficiary's bank accepts the sender's payment order at the earliest of the following times:

- (a) when the time within which a required notice of rejection should have been given has elapsed without notice having been given,
- (b) when the bank receives the payment order, provided that the sender and the bank have agreed that the bank will execute payment orders from the sender without notification that cover is in place,
- (c) when it notifies the sender of acceptance, or
- (d) when it sends a payment order intended to carry out the payment order received.

*Prior discussion*

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

*Comments*

1. The drafting group at the nineteenth session substantially restructured the portion of the draft Model Law dealing with acceptance of a payment order by a receiving bank and the statement of the obligations of a receiving bank. Under the new structure articles 5 and 6 deal with a receiving bank that is not the beneficiary's bank while articles 7 and 8 deal with the beneficiary's bank.

*Concept of acceptance*

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

3. In order to help resolve the controversy, the Secretariat prepared a report for the nineteenth session of the Working Group that described the criteria for determining when a receiving bank had accepted a payment order and

the consequences of acceptance (A/CN.9/WG.IV/WP.42, paras. 2 to 42). The matter was discussed at length by the Working Group at its nineteenth session, at the conclusion of which the Working Group decided to retain the use of the concept (A/CN.9/328, para. 52).

*Paragraph (1)*

4. Paragraph (1) contains elements that were previously in articles 5(1) and 7(1). However, it expresses the same substantive rules as in the prior text.

5. Except for certain obligations of notification of error set out in articles 6(2) and (3) and 8(1), (2) and (3), the receiving bank is not required to act upon a payment order it receives unless it accepts the order. Nevertheless, since the expectation is that a receiving bank will execute a payment order it has received, as a general principle it must notify the sender of its decision not to accept the order. However, the notification need not give any reason for the decision not to accept.

6. The only exception to the requirement that the sender be notified of rejection of the payment order is that the receiving bank need not do so if one of its reasons for the rejection is insufficient funds. This exception applies to several different fact situations that, perhaps, should be treated differently. Its clearest application is where the originator does not have a sufficient balance or line of credit to support a debit to its account in the originator's bank. It can be assumed that the originator is aware of its account balance and need not be informed that it is insufficient (A/CN.9/317, para. 82).

7. The exception also applies to payment orders sent by the originator's bank or an intermediary bank to a receiving bank, which may be either an intermediary bank or the beneficiary's bank. There may be insufficient funds because the sending bank's balance in its account with the receiving bank is insufficient. There may be insufficient funds because the sending and receiving banks are in a net settlement arrangement and the sending bank's intra-day net credit limit with the receiving bank has been reached. There may also be insufficient funds because the receiving bank has not received notice of the credit to its account with its correspondent bank. From the viewpoint of the receiving bank, the situation is the same as when it is the originator's account that is insufficient. From the viewpoint of the originator the situation is quite different since the originator has no way to know that the credit transfer is being delayed. Especially in the case of delayed notice of credit where the difficulty may be unknown to the sending bank, it may be thought that the credit transfer should not be delayed indefinitely without notice to it.

8. The Working Group discussed these issues at its nineteenth session without deciding whether they warranted a change in the current use of the words "insufficient funds" (A/CN.9/328, para. 15).

9. The text of article 5(1) following the eighteenth session of the Working Group stated that the obligation of the receiving bank to notify the sender of its decision that it

would not comply with the sender's payment order was subject to the contrary agreement of the sender and receiving bank. Although the drafting group deleted those words from the current text, the deletion did not indicate a change in policy on the part of the Working Group.

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

#### *Paragraph (2)*

11. Paragraph (2) contains the substance of former article 6(1), but substantially enlarged by the Working Group at its nineteenth session.

12. Acceptance of a payment order occurs through passage of time under paragraph 2(a) when a receiving bank is required to give notice of rejection under paragraph (1) and fails to do so in the required period of time. Once the order has been accepted, the receiving bank is bound on the order and will be liable for the consequences that would follow from a failure to execute it.

13. Paragraph 2(b) was originally in prior article 6(2)(a) and was applicable only to the beneficiary's bank. At the eighteenth session of the Working Group it was decided that the provision should be modified by adding to it a requirement that the beneficiary's bank had exhibited a volitional element before the beneficiary's bank was deemed to have accepted the payment order (A/CN.9/318, para. 137). However, the required volitional element was not added to the text at that session. At the nineteenth session of the Working Group the original provision was discussed at length in the context of the beneficiary's bank (A/CN.9/328, paras. 45 to 49). In favour of retaining the original text without any volitional element it was stated that contracts between banks that the receiving bank would execute payment orders when received even if funds were not yet available existed both in regard to multilateral net settlement systems and bilateral banking relations. They were entered into to increase the security of the operation of the funds transfer system. The legal security provided by those contractual obligations would be increased if the receiving bank was considered to have accepted the payment order as soon as it was received.

14. At the conclusion of the discussion it was decided to retain the original text as it applied to the beneficiary's bank and to extend the rule to receiving banks that were not the beneficiary's bank (A/CN.9/328, paras. 32 and 49).

15. Paragraph 2(c) providing that a receiving bank might expressly accept a payment order was added by the Working Group at its nineteenth session (A/CN.9/328,

paras. 29 to 31). In the discussion doubts were raised as to the likelihood that a receiving bank would expressly accept a payment order for future implementation, but it was suggested that in the case of a large transfer a bank might be asked whether it would be prepared to handle the transaction. Its agreement would function as an express acceptance of the order.

16. Paragraph 2(d) provides for the normal way in which a receiving bank that is not the beneficiary's bank would accept a payment order it had received, i.e. by sending its own payment order intended to carry out the payment order received. If the payment order sent is consistent with the payment order received, the undertaking of obligations by the receiving bank and the execution of the most important of those obligations under article 6(4) are simultaneous. However, a receiving bank accepts a payment order even when it sends its own order for the wrong amount, to an inappropriate bank or for credit to the account of the wrong beneficiary, so long as the payment order sent was intended to carry out the payment order received. If such an inconsistent payment order is sent, the undertaking of obligations and the failure to carry out those obligations are also simultaneous.

#### Article 6. *Obligations of receiving bank other than beneficiary's bank*

(1) The provisions of this article apply to a receiving bank other than the beneficiary's bank.

(2) When a payment order is received that contains information which indicates that it has been misdirected and which contains sufficient information to identify and trace the sender, the receiving bank shall notify the sender of the misdirection.

(3) If there is an inconsistency in a payment order between the words and figures that describe the amount of money, the receiving bank is required to notify the sender of the discrepancy unless the sender and the bank had agreed that the bank would rely upon either the words or the figures, as the case may be.

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

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

*Prior discussion*

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

*Comments**Paragraph (2)*

1. Paragraph (2) is identical to the first sentence of prior article 5(1 *bis*).
2. The Working Group decided at its eighteenth session that a receiving bank should be required to notify the sender when the payment order received indicated that it had been misdirected. The imposition of such a duty will help assure that the funds transfer system will function as intended (A/CN.9/318, para. 122). The duty applies whether or not the sender and the receiving bank have had any prior relationship, whether or not the receiving bank accepted the order and whether or not the bank recognized that the payment order had been misdirected (see A/CN.9/328, para. 18).
3. As the result of a concern expressed at the nineteenth session that the bank might not be able to fulfil its obligation even if it wished to, paragraph (2) was modified to provide that the receiving bank is required to notify the sender only if the identity of the sender and its address can be readily ascertained (A/CN.9/328, para. 20).

*Paragraph (3)*

4. Paragraph (3) is prior article 3(1). If the amount is expressed in both words and figures and there is a discrepancy, the receiving bank is required to notify the sender. The obligation to notify exists whether or not the receiving bank has accepted the payment order. If the receiving bank does not do so and it acts upon the incorrect amount, it is responsible for the consequences, even if it had no knowledge of the discrepancy.
5. The rule is expressed in general terms to apply to payment orders between any sender and receiving bank. However, it was the expectation in the Working Group that paragraph (3) would apply in fact only between the originator and the originator's bank, since interbank payment orders in electronic form transmit the amount of the transfer in figures only (A/CN.9/318, paras. 61 and 63).
6. Paragraph (3) makes the general rule subject to the agreement of the sender and the receiving bank that the receiving bank will act upon either the words or the figures, as the case may be. Such an agreement could be anticipated to provide that the bank would act upon the amount in figures.

*Time to give notice required by paragraphs (2) and (3)*

7. No indication is given in either paragraph as to when the required notice must be given. Presumably it must be given by the execution date, as for a notice of rejection in article 5(1) or 7(1). See discussion in article 9, comments 17 to 19.

*Paragraph (4)*

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

*Paragraph (5)*

9. Although a receiving bank is normally bound to follow any instructions in the payment order specifying an intermediary bank, funds transfer system or means of transmission, it can happen that it is not feasible to follow the instructions or that doing so would cause excessive costs or delay in completing the transfer (A/CN.9/328, para. 75). This paragraph gives the receiving bank an opportunity to make such a determination, so long as it does so in good faith. As an alternative, the receiving bank can enquire of the sender as to the actions it should take, but it must do so within the time required by article 9.

*Article 7. Acceptance or rejection by beneficiary's bank*

- (1) If the beneficiary's bank decides not to accept a sender's payment order, it is required to notify the sender of the rejection, unless one of the reasons is insufficient funds. A notice of rejection of a payment order must be given not later than on the execution date.
- (2) The beneficiary's bank accepts a payment order at the earliest of the following times:
  - (a) when the time within which a required notice of rejection should have been given has elapsed without notice having been given,
  - (b) when the bank receives the payment order, provided that the sender and the bank have agreed that the bank will execute payment orders received from the sender without notification that cover is in place,
  - (c) when it notifies the sender of acceptance,
  - (d) when the bank credits the beneficiary's account or otherwise pays the beneficiary,
  - (e) when the bank gives notice to the beneficiary that it has the right to withdraw the credit or the funds,
  - (f) when the bank otherwise applies the credit as instructed in the payment order,
  - (g) when the bank applies the credit to a debt of the beneficiary owed to it or applies it in conformity with an order of a court.

*Prior discussion*

- A/CN.9/297, paras. 46 to 51  
 A/CN.9/317, paras. 80 to 84  
 A/CN.9/318, paras. 110 to 120 and 135 to 143  
 A/CN.9/WG.IV/WP.42, paras. 32 to 42 and 59 to 65  
 A/CN.9/328, 44 to 51, 59 and 60

*Comments*

1. As a result of the restructuring of the draft Model Law by the drafting group at the nineteenth session of the Working Group, the provisions on the acceptance or rejection of a payment order by the beneficiary's bank were placed in an article separate from that containing similar provisions in respect of a receiving bank that is not the beneficiary's bank. The majority of the provisions are identical, with the exception of the way in which the bank is referred to. Consequently, the comments to article 5 relative to use of the concept of acceptance and to paragraphs (1) and (2)(a), (b) and (c) are applicable to article 7.
2. Paragraph 2(c), (d), (e), (f) and (g) represents various forms of volitional act by the beneficiary's bank to accept the payment order received by it. Subparagraphs (d) to (g) were carried over from prior article 6(2).
3. At the nineteenth session the Working Group deleted from what is currently paragraph (2)(d) the words that had been in square brackets "[without reserving a right to reverse the credit if cover is not furnished]" (A/CN.9/328, para. 49). Those words recognized a practice in some countries to allow a receiving bank, including a beneficiary's bank, to give the credit party provisional credit awaiting the receipt of cover from the sending bank.
4. The discussion at the nineteenth session recognized that the granting of provisional credit to the credit party had the advantage of making the processing of credit transfers more efficient in the vast majority of cases in which cover arrived at an appropriate time. Since the receiving bank was never required to grant provisional credit as a matter of law, it would do so only where it made the credit judgment that it was highly likely to receive the cover or that, if it did not, it could recover the provisional credit from the credit party. Such a credit judgment might be reflected in an agreement with a credit party to grant such provisional credit. Such an agreement would always authorize the receiving bank to re-evaluate its decision to grant provisional credit, although the bank might be required to give advance notice of its decision that it would no longer do so.
5. The discussion at the nineteenth session also noted that the possibility that provisional credit might be reversed introduced elements of insecurity into the funds transfer system that affected not only the credit party, but in extreme cases might endanger the functioning of the entire system. Therefore, the Working Group decided that it was undesirable for a receiving bank, including the beneficiary's bank, to be allowed to reverse a credit (A/CN.9/328, paras. 59 to 60).
6. In an associated discussion at the nineteenth session the Working Group engaged in a preliminary discussion of

the desirability of introducing a provision on netting into the Model Law. The Working Group noted that important studies on this issue were taking place elsewhere, and particularly in a committee of the central banks of the Group of Ten, presided by the General Manager of the Bank for International Settlements. Therefore, the Secretariat was requested to follow those developments and to report to the Working Group on the conclusions that had been reached, including the submission of a draft text for possible inclusion in the Model Law if that seemed appropriate (A/CN.9/328, paras. 61 to 65; see A/CN.9/WG.IV/WP.42, paras. 47 to 57).

*Article 8. Obligations of beneficiary's bank*

(1) When a payment order is received that contains information which indicates that it has been misdirected and which contains sufficient information to identify and trace the sender, the beneficiary's bank shall notify the sender of the misdirection.

(2) If there is an inconsistency in a payment order between the words and figures that describe the amount of money, the beneficiary's bank is required to notify the sender of the discrepancy unless the sender and the bank had agreed that the bank would rely upon either the words or the figures, as the case may be.

(3) Where the beneficiary is described by both words and figures, and the intended beneficiary is not identifiable with reasonable certainty, the beneficiary's bank must notify, within the time prescribed in article 9, paragraph (4), its sender, and also the originator's bank if it is identified on the payment order.

*(4) Variant A*

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

*Variant B*

A beneficiary's bank that accepts a payment order fulfils its obligations under that payment order

(a) if the beneficiary maintains an account at the beneficiary's bank into which funds are normally credited, by, in the manner and within the time prescribed by law, including article 9, or by agreement between the beneficiary and the bank

(i) crediting the account,

(ii) placing the funds at the disposal of the beneficiary, and

(iii) notifying the beneficiary; or

(b) if the beneficiary does not maintain an account at the beneficiary's bank, by

(i) making payment by the means specified in the order or by any commercially reasonable means, or

(ii) giving notice to the beneficiary that the bank is holding the funds for the benefit of the beneficiary.

*Prior discussion*

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

*Comments*

1. The restructuring of the text by the drafting group at the nineteenth session of the Working Group led to the duplication in article 8(1) and (2) of the text of article 6(2) and (3) with appropriate changes in the references to the relevant banks. Therefore, the comments to those paragraphs are relevant to article 8.

*Paragraph (3)*

2. Paragraph (3) applies only to a payment order received by the beneficiary's bank containing a discrepancy between the identification of the beneficiary in words and its identification in figures. No bank prior to the beneficiary's bank can be expected to have the information to be able to determine that such a discrepancy exists.

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

4. In order to reduce to a minimum the time during which the transfer is suspended, the notification to both the sender and the originator's bank must be done within the time specified in article 9(4), i.e. on the day the decision is made, but not later than the day the receiving bank was required to execute the order. It is anticipated that within a reasonable time the beneficiary's bank would receive further instructions as to the proper identification of the beneficiary, or an indication that the transfer was fraudulent.

*Time to give notice required by paragraphs (2), (3) and (4)*

5. Paragraph (3) states that the notification there required must be given within the time prescribed in article 9(4). The reference is in error; the paragraph cited (prior article 7(4)) was deleted in the redrafting of the draft Model Law at the nineteenth session.

6. As in respect of article 6 no indication is given in either paragraph (1) or (2) as to when the notice must be given, nor is there an effective time indicated in paragraph (3). Presumably the notice must be given by the execution date, as for a notice of rejection in article 5(1) or 7(1). See discussion in article 9, comments 17 to 19.

*Paragraph (4)*

7. The Working Group discussed at its nineteenth session the issue of the extent to which the Model Law should be

concerned with the relationship between the beneficiary and the beneficiary's bank. (A/CN.9/328, paras. 37 to 43; see A/CN.9/WG.IV/WP.42, paras. 58 to 68). The majority of the discussion related to the extent to which the Model Law should have rules in respect to the civil consequences of the credit transfer as in current article 14, but that discussion was generally relevant to the question as to whether paragraph (4) of article 8 should be retained in the Model Law. At the conclusion of the discussion the Working Group decided to defer any decision in respect of the consequences of acceptance of the payment order by the beneficiary's bank until it had discussed the time when acceptance took place. It did not have an opportunity to return to the question at the nineteenth session.

8. The text of paragraph (4) has not been considered by the Working Group, except for the opening words at the eighteenth session (A/CN.9/318, para. 156). However, the drafting group at the nineteenth session designated the prior text as Variant B and added a Variant A for consideration of the Working Group.

9. In A/CN.9/WG.IV/WP.41, article 5, comment 17 it was said that the propriety of including paragraph (4) within the Model Law might depend upon the ultimate decision as to whether the credit transfer was considered to be completed, with the legal consequences that would follow, when the beneficiary's bank accepted the payment order or only when the beneficiary's bank credited the beneficiary's account or performed a similar act. If the credit transfer is completed only when the beneficiary's bank credits the account or performs a similar act, there is less need to specify any further acts to be performed by the bank. Any further legal requirements as to the actions of the bank might be left to the law governing the account relationship.

10. However, at the nineteenth session the Working Group decided that in at least the situation when the sender and the receiving bank have agreed that the bank will execute payment orders received from the sender without notification that cover is in place, acceptance takes place on receipt of the payment order, prior to any volitional act on the part of the beneficiary's bank. As a result it may be thought useful to have some reference to the obligations of the beneficiary's bank towards the beneficiary. Furthermore, if it was felt useful to provide in the Model Law when the funds were available to the beneficiary, thereby fulfilling the obligations of the various banks when the originator has specified a "pay date", paragraph (4) would be relevant (see articles 2(m), 9(1)(b) and 12(4)(b)).

11. Variant A proposed by the drafting group at the nineteenth session refers only to the obligation of the beneficiary's bank to place the funds at the disposal of the beneficiary. The funds must be placed at his disposal in accordance with the payment order and the applicable law governing the relationship between the bank and the beneficiary. Such a provision would serve primarily as a reminder that the ultimate purpose of a credit transfer is to make funds available to the beneficiary.

12. Variant B is more detailed in that it sets forth the type of actions to be taken by the beneficiary's bank. However, it sets out neither the manner in which they are to be accomplished nor the time when they are to be accomplished. Those two elements are left to other rules of law or to agreement between the beneficiary and the bank. The single exception is a reference to certain provisions in article 9 as to when the beneficiary's bank must act.

*Article 9. Time for receiving bank to execute payment order*

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

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

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

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

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

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

*Prior discussion*

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

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

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

*Comments*

1. Following the discussion at the nineteenth session of the Working Group of the draft of prior article 7, which had been prepared by the Secretariat for the eighteenth session, a new draft was prepared by a small group (A/CN.9/328, para. 88). That draft was in turn discussed by the Working Group late in the nineteenth session. Suggestions were made for the small group to use in a further revision of the draft article which was to be presented for discussion at the twentieth session. It was recognized in the Working Group that, since the time when a receiving bank must act in respect of a payment order received affected several provisions, the restructuring of the draft Model Law being undertaken by the drafting group might affect the structure of paragraphs (1) and (2) (paras. 89 to 91). The current text of article 9 was prepared by the drafting group in the light of the comments made in the Working Group on the draft of article 7.

*Purpose of paragraph (1)*

2. The purpose of paragraph (1) is to state the times within which action must be taken in certain circumstances; it is not intended to state a substantive obligation to take action. That distinction is not always easy to preserve in the presentation of the provision, and it may not have been preserved in the opening words of paragraph (1). The various drafts prepared by the Secretariat and in the Working Group, and the various provisions of the current text, also reflect a difficulty in expressing the time limits within which the receiving bank must act.

*Same day execution*

3. The general rule stated in the *chapeau* to paragraph (1) is that a payment order is to be executed on the day it is received. That rule is repeated in substance in the second sentence of the definition of "execution date" in article 2(1): "When no execution date is stated on a payment order, the execution date of that order shall be deemed to be the date the order is received . . ."

4. By virtue of articles 5(1) and 7(1) "a notice of rejection of a payment order must be given not later than on the execution date", i.e. on the date the order was received according to the second sentence of article 2(1). Although the same result would be anticipated by reference to paragraph (1) of article 9, the wording used leaves the result uncertain.

5. The Working Group has at all times accepted the appropriateness of the general rule that a payment order must be executed, or notice of rejection given, on the day the order is received. Such a rule might not have been appropriate when credit transfers, including international credit transfers, were paper based. However, the vast majority of international credit transfers are currently transmitted by electronic means, and especially by on-line data transfer. In such an environment rapid execution by the receiving bank should normally be expected.

6. Nevertheless, the rule is strict and it is necessary that it be mitigated by several supplementary provisions. The first is the general rule that a receiving bank is not required to execute any payment order it receives, and is not required to give notice of rejection, if the reason for the failure to execute is that there are insufficient funds to pay the receiving bank for the payment order received. Therefore, a receiving bank that receives sufficient funds on a day later than the day the order is received and executes the payment order on that day is not in breach of its obligations under article 9(1). It would be in breach of those obligations if it had agreed with the sender that it would execute payment orders received from the sender without notification that cover was in place, since in such situations the receiving bank would have accepted the payment order when the order was received (articles 5(2)(b) and 7(2)(b)).

7. The second mitigating rule found in paragraph (2) recognizes that banks, and funds transfer systems of different types, establish cut-off times for the processing of payment orders for same day execution. There may be



different cut-off times for different types of payment orders. Any order received after the cut-off time is treated as having been received the following day the bank executes that type of payment order. There is no limit on when the cut-off time might be, and it is not unusual for cut-off times to be as early as noon.

8. The third mitigating rule found in paragraph (4) is that a branch of a bank, even if in the same country, is treated as being a separate bank for these purposes. Where the branches of a bank process payment orders on a decentralized basis, a payment order that is sent from one branch to a second branch requires the same amount of time to be executed at the branch as if the order was to be sent to a different bank (A/CN.9/328, para. 82).

9. A fourth mitigating rule found in the definition of "execution day" in article 2(1) is that the nature of the payment order may indicate that it would be appropriate to execute the order on a day other than the day the order was received. That phrase, which was first added to the rule before the sphere of application of the Model Law was restricted to international credit transfers, can be easily applied to bulk credit transfers of low value sent through a system that operates on a set time schedule, such as execution on the third day after receipt of the payment orders on magnetic tape. It may be less often applicable to international credit transfers which are, at least at present, less likely to follow such a time schedule.

#### *Execution date, pay date and value date*

10. The execution date, pay date and value date are defined in article 2(1), (m) and (n). All substantive rules governing the use of any one of the three dates were set forth in prior article 7. At the nineteenth session it was suggested that the value date only provided information to the receiving bank as to when it could expect to receive funds from the sender (A/CN.9/328, para. 79). As a result, even though the term is defined, article 9 contains no provision governing its use. The term has also been deleted from the other articles where it appeared.

11. The execution date is the date when the receiving bank is to execute the payment order as specified by the sender (article 2(1)). Although it would seem appropriate that the execution date could be specified either on the payment order or in a separate or standing instruction, the second sentence of article 2(1) seems to require that it be specified on the payment order. If no execution date has been specified by the sender, article 9(1) provides that the payment order is to be executed on the day it is received, subject to article 9(2) on cut-off times.

12. If the receiving bank executes the order prior to the execution date, the payment order is accepted (articles 5(2)(d) and 7(2)(d)) and the sender would no longer have the possibility to revoke the order (article 10(1)(b) and (2)(b)). At the nineteenth session it was stated that the sender should not lose its power to revoke its payment order prior to the execution date even if the order had been prematurely executed by the receiving bank (A/CN.9/328, para. 78). However, no provision to that effect was introduced into the draft Model Law by the drafting

group. Nevertheless, the sender is not required to pay the receiving bank until the execution date (article 4(4)).

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

14. The receiving bank's failure to execute a payment order on the execution date would lead to liability under article 12. The receiving bank might execute the payment order late because the order was received late. Under the prior text of article 7(2) the bank that received the order late complied with its obligations if it executed the order on the day received. Although no objection was expressed to that paragraph at the nineteenth session (A/CN.9/328, paras. 81 and 82), the paragraph was not included in the article as it was restructured by the drafting group. Therefore, under a strict reading of the current text the only safe course for the bank would be to reject the order, although even then the bank might be considered to have given a notice of rejection too late since the notice of rejection must be given by the same date as would be required for execution.

15. A pay date in a payment order sent to the beneficiary's bank should function as though it was the execution date. That would undoubtedly be the result where the funds were placed at the disposal of the beneficiary later than the pay date. The result is not clear under the current drafting of paragraph (1)(b) if the funds were placed at the disposal of the beneficiary prior to the pay date since the text refers to placing the funds at the disposal of the beneficiary "by the pay date". This latter wording seems to be in conflict with the definition in article 2(m).

16. While the pay date is of immediate importance in the payment order issued to the beneficiary's bank, since it is that bank that must place the funds at the disposal of the beneficiary, the pay date will almost assuredly have been specified by the originator. Article 2(m) recognizes this fact and incorporates it into the definition. The obligation of the originator's bank and any intermediary banks in regard to a payment order they receive that contains a pay date is to execute the order in sufficient time for the beneficiary's bank to be able to place the funds at the disposal of the beneficiary on the pay date. A provision to that general effect was included in prior article 7(1) and considerably more clearly in the proposal presented to the Working Group at the nineteenth session (see A/CN.9/328, para. 88, proposed article 7(1)(b)). Article 9 as presented by the drafting group at the nineteenth session does not include such a provision.

#### *Time within which notices must be given*

17. Prior article 7(4) provided

"A notice that a payment order will not be accepted must be given on the day the decision is made, but no later than the day the receiving bank was required to execute the order."

18. At the nineteenth session of the Working Group it was decided to delete any requirement of early notice of rejection in article 7(4) (A/CN.9/328, para. 86). The drafting group deleted the paragraph entirely, and put the requirements as to the time when notice of rejection must be made into articles 5(1) and 7(1).

19. Neither in the prior draft nor in the current draft is there provision for the time when the notices required by articles 6(1) and (2) and 8(1) and (2) must be given. As to the notice required by article 8(3), see article 8, comment 5.

#### Article 10. *Revocation*

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

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

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

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

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

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

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

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

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

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

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

(6) If a sender who, under paragraph (5), is not obligated to pay the receiving bank has already paid the

receiving bank for the revoked payment order, the sender is entitled to recover the funds paid.

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

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

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

#### *Prior discussion*

A/CN.9/297, para. 79 and 92 to 95

A/CN.9/317, paras. 68 and 120 to 133

A/CN.9/328, paras. 92 to 116

#### *Comments*

1. Article 10 provides a framework for the revocation of payment orders after they have been received by the receiving bank. At the nineteenth session of the Working Group it was suggested that, since international credit transfers are almost always sent by on-line telecommunications and are processed by computer, there would be little opportunity for the sender to revoke the payment order before the order was executed by the receiving bank and that it was, therefore, unnecessary to have any provision on the subject. The reply was given that a revocation that did not arrive in time because of the use of high-speed electronic systems would not be effective. That was not, however, considered to be sufficient reason to preclude the originator or other sender from having the opportunity to attempt to revoke the order (A/CN.9/328, paras. 93 and 94).

2. The text presented to the nineteenth session of the Working Group had one set of rules that covered both the revocation and the amendment of payment orders. At the nineteenth session it was noted that the amendment of payment orders might raise additional policy issues to those raised by the revocation of orders (A/CN.9/328, para. 100). As a result article 10 refers only to the revocation of payment orders and no provision is made in the current draft for their amendment.

#### *Paragraphs (1) and (2)*

3. Paragraphs (1) and (2) provide essentially the same rules for the revocation of a payment order sent to a receiving bank that is not a beneficiary's bank and to a receiving bank that is a beneficiary's bank. In both cases the revocation can be sent only by the sender of the payment order; neither the originator nor an earlier bank in the credit transfer chain can revoke the order even though it may be the party interested in having the order revoked. The means of revoking a credit transfer when it is too late to revoke the specific payment order are considered in paragraph (4).

4. In both cases the payment order can be revoked only if the revocation is received by the receiving bank in time. In the case of a receiving bank that is not the beneficiary's bank, the event that marks the termination of the right to revoke is the execution of the order by the receiving bank. Although the current draft of the Model Law does not define what constitutes execution of the order by the receiving bank, it can be assumed to be the sending of its own payment order intended to carry out the order received (compare article 5(2)(d) with article 6(4)). While sending its own order would also constitute acceptance of the order received, other forms of acceptance under article 5(2) would not constitute execution of the order received. In the case of the beneficiary's bank, the event that marks the termination of the right to revoke is the acceptance of the order by the bank in any of the ways described in article 7(2).

5. The receiving bank is given a certain period of time to act upon the revocation received. This period must be "sufficient" to enable the bank "if it acts as promptly as possible under the circumstances," to cancel the execution of its own order or to refrain from accepting the order received, as the case may be. The period as so defined is by its nature subjective, since it depends on the ability of the receiving bank to act (A/CN.9/328, paras. 96 and 116). The time required will vary from one bank to another, indeed from one branch of a bank to another, and depend on the nature of the payment order and the means of communication of the revocation.

6. The revocation must be authenticated in the same manner as the payment order. This implies that the revocation must be sent by the same means of communication as was the payment order. When this wording was questioned at the nineteenth session of the Working Group, citing the case of a paper-based payment order that was revoked by a telex, the reply was given that an attempt had been made to draft a requirement that the authentication had to be as good as or better than the authentication of the payment order being revoked, but that it had not proven possible to do so (A/CN.9/328, para. 114). An appropriate result might be more easily achieved by amending the definition of "authentication" and of article 4(2) as suggested in article 2, comment 23 and article 4, comment 10.

7. At the nineteenth session of the Working Group it was stated that the sender should not lose its power to revoke its payment order prior to the execution date even if the order had been prematurely executed by the receiving bank (A/CN.9/328, para. 78; see article 9, comment 12).

#### *Paragraph (3)*

8. Paragraph (3) was introduced into the draft Model Law at the nineteenth session of the Working Group (A/CN.9/328, para. 98). Agreements restricting the right of a sender to revoke a payment order are common in multilateral payment arrangements, especially where there is delayed net settlement and in batch processing systems where it may be difficult, if not impossible, to extract a single payment order from the batch. Paragraph (3) probably does not apply to a restriction in a telecommunications message system that prohibits the withdrawal of a mes-

sage once sent. Even a telex cannot be withdrawn as a message from the public telecommunications system once it has been sent; however, the order contained in the message can be revoked under paragraph (1) or (2).

9. When paragraph (3) was introduced at the nineteenth session of the Working Group, concern was expressed over its effect since the originator might not know that there were agreements between particular banks through which the credit transfer might pass that made a payment order between those banks irrevocable (A/CN.9/328, para. 115). An agreement of a clearing-house, for example, through which the originator's bank sent the payment order to an intermediary bank that restricted the right to revoke the order would preclude the originator from revoking the credit transfer even though the beneficiary's bank had not yet accepted an order to carry out the transfer. That result is explicitly provided in paragraph (4).

#### *Paragraph (4)*

10. If a receiving bank has already issued its own payment order intended to carry out the payment order received, paragraph (4) provides that it shall issue its own revocation to its receiving bank. The obligation is automatic and is not dependent upon the request of the sender, but it is dependent on there not being an agreement restricting the right of the receiving bank as a sender to revoke its own order as described in paragraph (3). The effectiveness of the revocation is tested under paragraph (1) or (2). The series of messages can go from bank to bank until a payment order is revoked or the beneficiary's bank is reached. The credit transfer can no longer be interrupted by revocation of a payment order once the beneficiary's bank has accepted an order implementing the transfer.

#### *Paragraphs (5) and (6)*

11. These two paragraphs specify that a sender who has sent a revocation that was or should have been effective is not obligated to pay for the payment order, as he would otherwise be under article 4(4), and is entitled to recover any funds paid. At the nineteenth session it was suggested that the sender should be entitled to receive back the original amount of the transfer less costs. This was said to be a question that arose in respect of the reimbursement of the funds in case of an unsuccessful credit transfer as well and that it would need to be addressed at a later stage (A/CN.9/328, para. 115). It may be thought that a sender who has a right to a refund under paragraph (6) should also have a right to interest on the funds for the period of time the sender was deprived of the use of those funds. Compare article 12, comment 14.

#### *Paragraph (7)*

12. If a bank has executed a payment order in spite of receipt of an effective revocation, there is a likelihood that the funds will eventually be credited to the account of the beneficiary. Paragraph (7) gives the bank that made the error and was required to reimburse its sender the means to recover the funds by being assigned any right the originator may have had to recover the funds from the beneficiary.

13. Under some circumstances paragraph (7) will not give the bank the full protection that was anticipated and the originator may have an unjustified profit. Although the sender has a complete right to recover the funds from the bank that made the error under paragraph (6), the originator may not have a right to recover the funds from the beneficiary because it owed that amount to the beneficiary. The right assigned to the bank that made the error could be no greater than the right of the originator.

14. To some degree paragraph (7) is a replacement for prior article 8(7), that was deleted by the Working Group at its nineteenth session (A/CN.9/328, para. 106). That provision would have given the beneficiary's bank a right to reverse a credit entered to the beneficiary's account that met certain objective criteria of being the result of an error or fraud. For the origin of prior article 8 see A/CN.9/297, para. 79 and A/CN.9/317, para. 68. The current text of paragraph (7) is severely restricted in its field of application compared to the earlier provision.

#### *New proposal*

15. Former article 8(8) provided that a bank has no obligation to release the funds received if ordered by a competent court not to do so. When it deleted that paragraph at its nineteenth session the Working Group decided that it would consider a proposal that was to be presented authorizing courts to restrain a bank from acting on a payment order if proper cause was shown (A/CN.9/328, para. 109).

16. A proposal presented to the nineteenth session but not considered by the Working Group at that time provided

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

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

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

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

#### Article 11. *[Assistance and refund]*

A receiving bank other than the beneficiary's bank that accepts a payment order is obligated under that order:

- (a) where a payment order is issued to a beneficiary's bank in an amount less than the amount in the payment order issued by the originator to the origina-

tor's bank—to assist the originator and each subsequent sending bank, and to seek the assistance of its receiving bank, to obtain the issuance of a payment order to the beneficiary's bank for the difference between the amount paid to the beneficiary's bank and the amount stated in the payment order issued by the originator to the originator's bank;

(b) where a payment order consistent with the contents of the payment order issued by the originator and containing instructions necessary to implement the credit transfer in an appropriate manner is not issued to or accepted by the beneficiary's bank—to refund to its sender any funds received from its sender, and the receiving bank is entitled to the return of any funds it has paid to its receiving bank.

#### *Prior discussion*

A/CN.9/318, paras. 151 to 154  
A/CN.9/328, paras. 54 to 58

#### *Comments*

1. Article 11 sets forth the basic obligations of a receiving bank to rectify the situation if problems arise in the implementation of a credit transfer. It contains prior article 5(3)(b) and (c) with the order of the two subparagraphs reversed. The drafting group could not decide on a proper title for this new article, so it placed the provisional title in square brackets.

#### *Subparagraph (a)*

2. The first obligation of a receiving bank when the credit transfer has not been successfully carried out is to take the necessary steps to cause it to be carried out. If the receiving bank is the cause of the difficulties, it would carry out its obligation under subparagraph (a) by taking the necessary actions itself. If the difficulties occurred at a subsequent bank in the credit transfer chain, the receiving bank would be obligated to assist in causing the transfer to be carried out properly by such actions as finding out where the problem had occurred or sending new instructions to the subsequent bank.

3. Subparagraph (a) was adopted at the eighteenth session of the Working Group and was not discussed at the nineteenth session. However, the drafting group at the nineteenth session made a minor change in the text by referring to the issuance of a payment order for an amount "less" than, rather than an amount "different" from, the amount in the originator's payment order. That change made the provision more precise but did not change its substantive application, since the prior wording could itself have been applied only when the payment order had been for less than the correct amount. Consideration might be given to extending the subparagraph to the case where no payment order has been issued to the beneficiary's bank, a result that cannot be reached by interpretation of the current text.

#### *Subparagraph (b)*

4. Subparagraph (b) sets forth one of the most important rules in the draft Model Law; if the credit transfer is not

carried out in a manner consistent with the payment order issued by the originator, the sender has a right to a refund of any funds it has paid to the receiving bank. This right ultimately accrues to the benefit of the originator as the sender of the first payment order in the credit transfer chain.

5. Two different situations are envisaged under subparagraph (b): no payment order was accepted by the beneficiary's bank (perhaps because none was issued to it) and a payment order was accepted but it was inconsistent with the originator's payment order in some manner other than that it was for too small an amount. Subparagraph (b) as drafted would also apply where the payment order was for too small an amount, but in such a case the subparagraph should normally apply only to the deficiency and only if subparagraph (a) does not remedy the situation. It might apply to the entire amount in the rare situation where the transfer of too small an amount rendered the transfer commercially valueless.

6. The reason a credit transfer is not carried out successfully may be that the indication of the beneficiary or of the beneficiary's bank was incorrect on one of the payment orders in the transfer chain by reason of error or fraud. Other reasons why a credit transfer may fail to be carried out successfully are that the imposition of currency restrictions prevents the transfer from being made, for some reason a transfer cannot be made to the beneficiary's bank or to the country where the beneficiary's bank is located, the beneficiary's bank refuses to accept the payment order addressed to it or the account of the beneficiary is no longer open to receive credit transfers. In most cases where the indication of the incorrect beneficiary or beneficiary's bank was the result of an error, it could be expected that the error would be corrected and the credit transfer would be carried out as directed, though perhaps late. If the credit to the beneficiary's account is for an amount greater than the amount specified in the originator's payment order, subparagraph (b) should be interpreted to permit the sender to recover the payment it had made in excess of the correct amount, and it might be desirable to say so explicitly.

7. Although the general policy decision made by the Working Group at its sixteenth session and affirmed on several occasions that the originator should be able to hold its bank responsible for proper performance of the credit transfer is still open to discussion (A/CN.9/297, paras. 55 to 60; see A/CN.9/328, paras. 66 to 74 and 144), the application of that policy to the return of the principal sum where the credit transfer failed was strongly endorsed at the nineteenth session (A/CN.9/328, paras. 54 to 58). The obligation of the receiving bank is absolute and the exemptions of article 13 would not apply. At the eighteenth session the Working Group rejected a suggestion that the obligation of a receiving bank should be to assign to its sender the right of reimbursement it would have from its receiving bank (A/CN.9/318, para. 153). The result of that suggestion would have been to place on the originator the obligation to pursue its claim for reimbursement from a subsequent bank in the transfer chain and to bear the risk that the reimbursement could not be fully recovered.

8. At the nineteenth session a suggestion was made that the amount of the funds to be returned should be the original amount of the transfer less costs. It was said that this issue would have to be addressed at a later time (A/CN.9/328, para. 115). The Working Group may also wish to consider whether the sender would have a right to interest on the amount to be repaid to it. Compare the discussion at the nineteenth session, (A/CN.9/328, paras. 121 to 132.)

#### Article 12. *Liability of receiving bank*

[(1) A receiving bank that fails in its obligations under article 5 is liable therefor to its sender and to the originator.]

(2) The originator's bank and each intermediary bank that accepts a payment order is liable to its sender and to the originator for the losses as set out in paragraph (5) of this article caused by the non-execution or the improper execution of the credit transfer as instructed in the originator's payment order. The credit transfer is properly executed if a payment order consistent with the payment order issued by the originator is accepted by the beneficiary's bank within the time required by article 9.

(3) An intermediary bank is not liable under paragraph (2) if the payment order received by the beneficiary's bank was consistent with the payment order received by the intermediary bank and it executed the payment order received by it within the time required by article 9.

(4) The beneficiary's bank is liable

(a) to the beneficiary for its improper execution or its failure to execute a payment order it has accepted to the extent provided by the law governing the [account relationship] [relationship between the beneficiary and the bank], and

(b) to its sender and to the originator for any losses caused by the bank's failure to place the funds at the disposal of the beneficiary in accordance with the terms of a pay date or execution date stated in the order, as provided in article 9.

(5) If a bank is liable under this article to the originator or to its sender, it is obliged to compensate for

(a) loss of interest,

(b) loss caused by a change in exchange rates,

(c) expenses incurred for a new payment order [and for reasonable costs of legal representation],\*

(d) any other loss that may have occurred as a result, if the improper [or late] execution or failure to execute resulted from an act or omission of the bank done with the intent to cause such improper [or late] execution or failure to execute, or recklessly and with knowledge that such improper [or late] execution or failure to execute would probably result.

\*Consideration may be given to allowing recovery of reasonable costs of legal representation even if they are not recoverable under the law of civil procedure.

(6) If a receiving bank fails to notify the sender of a misdirected payment order as provided in article 6(2) or 8(1), and the credit transfer is delayed, the receiving bank shall be liable:

(a) if there are funds available, for interest on the funds that are available for the time they are available to the receiving bank, or

(b) if there are no funds available, for interest on the amount of the payment order for an appropriate period of time, not to exceed 30 days.

(7) Banks may vary the provisions of this article by agreement to the extent that it increases or reduces the liability of the receiving bank to another bank and to the extent that the act or omission would not be described by paragraph (5)(d). A bank may agree to increase its liability to an originator that is not a bank but may not reduce its liability to such an originator.

(8) The remedies provided in this article do not depend upon the existence of a pre-existing relationship between the parties, whether contractual or otherwise. These remedies shall be exclusive and no other remedy arising out of other doctrines of law shall be available.

#### *Prior discussion*

A/CN.9/297, paras. 55 to 63 and 70 to 72

A/CN.9/317, paras. 137 to 150

A/CN.9/328, paras. 66 to 74 and 117 to 144

#### *Comments*

##### *Paragraph (1)*

1. Paragraph (1) provides that a receiving bank is liable for its failure to fulfil its own obligations under article 5. Since there is a reference to article 5, the receiving bank contemplated is not the beneficiary's bank. The liability of the beneficiary's bank is considered in paragraph (4). At its nineteenth session the Working Group decided to retain the principle of paragraph (1), but to place it in square brackets until it had completed its consideration of the entire article on liability and damages in the expectation that it might be substantially redrafted (A/CN.9/328, para. 131).

##### *Paragraph (2)*

2. The general system of liability in paragraph (2) is that the originator can hold the originator's bank liable for the proper performance of the credit transfer. That means that the bank would be responsible to the originator for loss wherever the loss occurred. In order to avoid liability the originator's bank would have to show that one of the exempting conditions in article 13 was relevant. If the loss for which the originator's bank is liable to the originator was caused by events that occurred at a subsequent bank in the credit transfer chain, the originator's bank can recover the loss from its receiving bank and each bank in turn could recover from its receiving bank until, under paragraph (3), a bank could show that the payment order received by the beneficiary's bank was consistent with the payment order received by the bank in question.

3. It was decided at the seventeenth session of the Working Group that the originator should also be able to hold an intermediary bank directly liable for the losses suffered, since there may be occasions when recovery from the originator's bank may not be possible (A/CN.9/317, para. 139).

4. This system of liability was discussed at length at the nineteenth session without a final decision being reached as to whether it should be retained or abandoned (A/CN.9/328, paras. 66 to 74 and 144).

5. Other decisions that have been made by the Working Group in respect of liability and damages, especially at the nineteenth session, may have a bearing on the significance of the provision. It has been decided that when a credit transfer is not carried out successfully, the originator has a right to a return of the principal sum transferred without regard to the reasons for the failure (article 11(b)). Although article 11(b) could be considered to implement the policy of paragraph (2), it is not considered to be a liability provision.

6. At the nineteenth session the Working Group decided that it would consider providing in the Model Law that, when there was a delay in a credit transfer, the beneficiary would have a direct right to recover interest resulting from the delay against the bank that had caused the delay. A similar right to recover for exchange losses is also to be considered (A/CN.9/328, paras. 131 and 132). A text that might implement those suggestion can be found in comment 17, below. If those proposals are accepted, the only remaining losses that would be subject to the procedures envisioned in paragraph (2) would be the expenses for a new payment order and reasonable costs of legal representation under paragraph (5)(c), the indirect losses envisioned under paragraph (5)(d) and any interest or exchange losses that were not fully compensated by payment to the beneficiary.

##### *Paragraph (3)*

7. Paragraph (3) places a limit on the effect of paragraph (2) when the credit transfer is completed, but in a manner inconsistent with the originator's payment order. No bank that is subsequent to the error or fraud that caused the inconsistency has any liability for the fact that the credit transfer was carried out improperly. However, such a bank would have obligations under article 11 to assist in correcting the situation.

##### *Paragraph (4)*

8. The beneficiary's bank might cause loss to the beneficiary by such actions as failing to fulfil its obligations under article 8(4), by failing to accept a payment order it is obligated by contract with the beneficiary to accept or by accepting a payment order the beneficiary has instructed it not to accept.

9. It is a matter of judgment whether the Model Law should contain provisions covering such losses. On the one hand the losses would arise out of the failure in respect of the credit transfer. On the other hand it may be thought that it is not necessary to establish rules on the liability of

the beneficiary's bank to the beneficiary, especially when those rules might differ from the domestic rules governing liability for an otherwise identical failure by the bank. Paragraph (4)(a) takes a middle position by referring to the existence of such liability but leaves the substance of the rules governing the liability to the law that governs the account relationship. At the seventeenth session the Working Group decided to defer any decision whether to retain or to delete the subparagraph until it had a more complete view of the entire text (A/CN.9/317, para. 150). The paragraph was not considered at either the eighteenth or nineteenth session of the Working Group.

10. The beneficiary's bank might cause loss to the sender or to the originator by failing to give one of the notices required by article 8(1), (2) or (3). Failure to give a notice of rejection required by article 7(1) would not cause loss to the sender or to the originator since it would lead to acceptance of the payment order by the beneficiary's bank. In addition, as indicated in paragraph (4)(b), the beneficiary's bank might cause loss to the sender or to the originator by failing to place funds at the disposal of the beneficiary in accordance with an execution or pay date. Compare article 8, comment 10.

#### *Paragraph (5)*

11. In essence, paragraph (5) applies to losses caused by late or non-completion of a credit transfer. In this sense, timely completion of a transfer for less than the full amount may be considered to be a late transfer for the difference between the proper amount and the amount transferred in fact.

12. Losses arising out of unauthorized payment orders are allocated by article 4(2) and (3). Liability for losses arising out of failure to give the notice required by articles 6(2) and 8(1) is set out in paragraph (6). The obligation of each receiving bank to refund to its sender any funds received from the sender where the transfer was not successfully completed is set forth in article 11(b).

#### *Interest, subparagraph (a)*

13. Interest losses may be suffered in several different ways as a result of a credit transfer that does not work as intended. If a receiving bank receives funds from its sender but delays execution of the payment order, the sender (who may be either the originator or a sending bank) may be said to have suffered a loss of interest because it has been deprived of funds earlier than was necessary for the bank to execute the payment order. If the receiving bank receives funds late from its sender but executes the order without waiting for the funds, the receiving bank suffers the loss of interest. If the result of a delay or error of any kind at a receiving bank is that the entire credit transfer is delayed, the beneficiary could be said to have suffered the loss of interest. If the beneficiary could recover loss of interest from the originator because of late payment of the underlying obligation, the originator would be able to recover it from the bank where the delay occurred under paragraph (1) or from the originator's bank under paragraph (2).

14. The Working Group considered the problem extensively at the nineteenth session (A/CN.9/328, paras. 122 to 131). It agreed that in any case where the beneficiary had been credited later than it should have been because of a delay in the transfer, the receiving bank causing the delay should not benefit from the use of the funds during the period of the delay (para. 122). It noted that it was current banking practice in many important banking centres for a bank at which a transfer was delayed to add an appropriate amount of interest to the amount being transferred. As a result the beneficiary would automatically receive it. This was said to be efficient and expeditious, not requiring any inquiry into the facts of the underlying transaction but giving a remedy that would normally be approximately equal to the loss suffered, and a practice that the legal system should recognize (para. 126).

15. At the conclusion of the discussion the Working Group decided that it would be useful to consider providing in the Model Law that the beneficiary would have a direct right to recover interest resulting from the delay against the bank that caused the delay. Since the proposal raised a number of questions that would require consultation, the Working Group requested the Secretariat to prepare a draft of a provision for its consideration at its next session (para. 131). For the suggested provision, see para. 17, below.

#### *Exchange losses, subparagraph (b)*

16. The second most likely form of loss arising out of delayed international credit transfers are exchange losses, as provided in subparagraph (5)(b). There was strong opposition in the nineteenth session of the Working Group to providing that exchange losses would be recoverable, especially in view of the fact that such losses were rare, usually arising only when the originator's bank was a small bank that did not often engage in international transfers or when the currency of the transfer was in a currency that was not frequently used for international transfers, and that neither the fact that such losses would occur nor the potential amount of loss was foreseeable. (A/CN.9/328, paras. 133 and 134). Nevertheless, it was decided that the Secretariat should include in the provision it was to prepare giving the beneficiary a direct right to recover for interest losses a right to recover for loss caused by a change in exchange rates during the delay (para. 132).

#### *Proposed new provision*

17. The Secretariat suggests the following provision to implement the suggestions made:

"If a sender is in delay in paying its receiving bank, the sender is liable to the receiving bank for interest. If a credit transfer is delayed by the improper execution of a payment order that has been accepted by a receiving bank, the bank is liable to the beneficiary for interest and any exchange losses resulting from late execution of the transfer. The liability of the bank to its receiving bank and to the beneficiary is discharged to the extent it transfers to its receiving bank an amount in addition to that it received from its sender."

18. The suggested provision combines two ideas that are theoretically separate but which overlap in practice. First, the bank may make funds available to its receiving bank subsequent to an expressed value date or subsequent to the execution or pay date. In such a case it would be expected that the receiving bank would normally execute the payment order received, thereby paying its credit party prior to the time it received funds from its sender. This is the situation in which a sending bank is most likely to add to the amount of the transfer an amount calculated to compensate its receiving bank for the delay. In some banking systems the rate of interest to be applied in such cases is established by interbank agreement.

19. If the receiving bank executes the payment order received without waiting for payment from its sender, the credit transfer as a whole may not be delayed. However, the credit transfer as a whole may be delayed when the receiving bank waits to receive the funds before it executes the payment order or when there is other improper execution of the payment order by the sending bank. In such a case the proposed provision gives the beneficiary a direct right against the sending bank for interest and for any exchange losses suffered as a result.

20. The question arises as to the effect on the sending bank's liability to the beneficiary when it adds a sum to the amount of the transfer for the interest loss caused by the delay. It should be evident that the sending bank's action would have at least the effect of discharging the sending bank's liability to the extent of the sum added if the sum is passed on to the beneficiary, and it should not be necessary to say so in the Model Law. However, it is possible to conclude that the sum, if it is an appropriate amount of interest in the interbank lending market that would discharge its obligation to its receiving bank, would constitute a complete discharge of the sending bank's obligation to the beneficiary even though the interest loss to the beneficiary is greater than the interest loss to the receiving bank would have been. The proposed provision rejects such a conclusion.

21. Moreover, it is possible to conclude that if the receiving bank were to retain the additional sum to compensate itself for the sending bank's delay, the sending bank's obligation to the beneficiary would remain intact. The proposed provision rejects that conclusion as well. The sending bank's obligation would be discharged to the extent of the additional sum and the beneficiary would have to look to the receiving bank that retained the sum for that amount. It would be the expectation of the Secretariat that this situation would be rare, but it has no empirical evidence to justify its expectation.

22. The proposed provision leaves open several questions that did not seem to require a statutory solution. The first is that just discussed, i.e. the right of the beneficiary against the receiving bank that retained the sum representing the interest for the delay. A second is the effect on any claim the beneficiary may have against the originator for late payment of the underlying obligation. While there would not seem to be great difficulty in concluding that payment of interest to the beneficiary for the delay in the

credit transfer would reduce by an equal amount any claim against the originator on the underlying obligation, the question is unlikely to be of great economic significance. While the originator might delay payment of an underlying obligation for such a significant period of time that substantial interest is due to the beneficiary, it would be unusual for the transfer to be for such a substantial amount of money and the delay to be for such a substantial period of time that the difference in interest between that due on the underlying obligation for the period of the delay and the amount added to the transfer by the bank causing the delay would be of great economic significance.

*Expenses of new payment order and legal representation, subparagraph (c)*

23. It was suggested at the nineteenth session of the Working Group that the first part of subparagraph (5)(c) was not of great importance because the amounts of money involved were minor, and the receiving bank might well have to bear the expenses of a new payment order as part of its obligation under article 11(a) to help rectify a credit transfer that had not been carried out properly. The second part of the subparagraph was put in brackets and the footnote was added because of the difficulties of formulating a rule that reflected the various means by which the costs of legal representation were distributed in the different legal systems (A/CN.9/328, paras. 137 to 139).

*Other losses, subparagraph (d)*

24. In respect of paragraph (5)(d) the Working Group decided at its seventeenth session that, in exchange for a relatively strict regime of liability, the bank liable would not be responsible for indirect losses unless more stringent requirements were met than for the other elements of loss (A/CN.9/317, paras. 115 to 117). That decision was re-affirmed in another context at the eighteenth session of the Working Group (A/CN.9/318, paras. 146 to 150). As suggested at the seventeenth session the formula used in the current text was taken from article 8 of the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules). In order to recover the indirect losses, the claimant would have to prove the intent or the reckless behaviour of the bank.

25. At the nineteenth session retention of the essence of the provision was again re-affirmed (A/CN.9/328, paras. 140 to 143). However, the formulation of the subparagraph was criticized as being imprecise. It was said that the subparagraph was not clear as to the types of losses that were to be covered or that those losses should have been the direct consequence of the failure on the part of the bank. The formula taken from article 8 of the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg Rules) for limiting the right to recover was said not to reflect properly the problems of making credit transfers (para. 142). After discussion the Working Group decided to place square brackets around the words "any other loss" and around the words taken from the Hamburg Rules to indicate its intention of redrafting the provision.



*Paragraph (6)*

26. In most cases of breach of duty under the Model Law the harm that is suffered is reasonably clear and the remedy of the injured party can be left to the general provisions of paragraph (5). When the Working Group adopted the provision requiring a receiving bank to notify its sender of a misdirected payment order, articles 6(2) and 8(1) in the current draft, it noted that the harm suffered might not always be easy to measure. Nevertheless, it was of the view that there should be a sanction for a bank's failure to notify the sender where that failure to notify delayed the transfer (A/CN.9/318, para. 122). Where the receiving bank was in possession of funds during the period it failed to notify the sender of the misdirection, the obligation to pay interest is in the nature of restitution of what the bank can be assumed to have earned from having been in possession of the funds as well as what the sender can be assumed to have lost. Where the receiving bank was not in possession of funds, the requirement to pay interest for up to 30 days serves only as a measure of the loss the sender can be assumed to have suffered.

*Paragraph (7)*

27. Paragraph (7) provides an important rule setting forth the extent to which the provisions of this article can be varied by agreement of the parties.

*Paragraph (8)*

28. Paragraph (8), making the liability provisions of this article not dependent on a contractual relationship and making them exclusive, was added at the suggestion of the Working Group at its seventeenth session (A/CN.9/317, para. 119). Without such a provision some legal systems might permit other remedies based on general theories of obligation, thereby destroying the uniformity of law the Model Law seeks to achieve.

*Article 13. Exemption from liability*

A receiving bank and any bank to which the receiving bank is directly or indirectly liable under article 12 is exempt from liability for a failure to perform any of its obligations if the bank proves that the failure was due to the order of a court or to interruption of communication facilities or equipment failure, suspension of payments by another bank, war, emergency conditions or other circumstances that the bank could not reasonably be expected to have taken into account at the time of the credit transfer or if the bank proves that it could not reasonably have avoided the event or overcome it or its consequences.

*Prior discussion*

A/CN.9/297, para. 60

A/CN.9/317, paras. 151 to 156

*Comments*

1. Since the liability of a receiving bank for the interest loss, loss caused by a change in exchange rates and expenses incurred for a new payment order would arise out of the simple fact of failure of the transfer, article 13

provides the receiving bank with its sole basis of defence in such cases.

2. Article 13 does not apply to the obligation of a receiving bank under article 11(b) to refund to its sender any funds received from the sender when a payment order consistent with the contents of the payment order issued by the originator was not issued or accepted by the beneficiary's bank. It also does not seem to apply to the bank's obligation to pay "any other loss" under article 12(5)(d), since that provision has its own strict limitation on liability. (See article 12, comments 24 and 25.) Furthermore, it can be questioned whether the application of article 13 to loss of interest would be consistent with the decision of the Working Group at its nineteenth session that a bank that caused a delay in a credit transfer should not be allowed to earn interest on the funds that were in its possession because of the delay (A/CN.9/328, para. 122) or with the decision at the seventeenth session that the receiving bank that fails to notify its sender of a misdirected payment order should be liable for interest. (See article 12, comment 26.)

3. Under article 13 the bank must prove the exempting condition. Although there is a list of specific circumstances that might exempt the bank from liability, other circumstances not listed might also do so. The current draft of article 13 has not been discussed by the Working Group.

#### CHAPTER IV. CIVIL CONSEQUENCES OF CREDIT TRANSFER

##### *Article 14. Payment and discharge of monetary obligations; obligation of bank to account holder*

(1) Unless otherwise agreed by the parties, payment of a monetary obligation may be made by a credit transfer to an account of the beneficiary in a bank.

(2) The obligation of the debtor is discharged and the beneficiary's bank is indebted to the beneficiary to the extent of the payment order received by the beneficiary's bank when the payment order is accepted by the beneficiary's bank.

(3) If one or more intermediary banks have deducted charges from the amount of the credit transfer, the obligation is discharged by the amount of those charges in addition to the amount of the payment order as received by the beneficiary's bank. Unless otherwise agreed, the debtor is bound to compensate the creditor for the amount of those charges.

(4) To the extent that a receiving bank has a right of reimbursement from a sender by debit to an account held by the receiving bank for the sender, the account shall be deemed to be debited when the receiving bank accepts the payment order.

*Prior discussion*

A/CN.9/317, paras. 157 to 164

A/CN.9/328, paras. 37 to 43

*Comments*

1. This article contains a number of important provisions that are associated with the credit transfer, though they do not have to do with the credit transfer itself. In many countries such provisions would not be included in a law governing credit transfers, while in others they would be included. They are included in this draft because it is important to keep them in mind even if it is decided at a later time to exclude some or all of this article from the final text of the Model Law. Furthermore, if any portion of this article is excluded from the final text, consideration might be given to preparing a separate text containing provisions on these issues so as to be sure that these rules would be consistent with the rules on the credit transfer itself (A/CN.9/328, para. 41).

*Paragraph (1)*

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

3. The Working Group agreed at its seventeenth session that paragraph (1) should be restricted to providing that an obligation could be discharged by a transfer without considering to what account the debtor-originator might have the funds sent (A/CN.9/317, para. 159). At the nineteenth session the question was raised as to whether the provision would limit the beneficiary's right to require payment to it in legal tender or to reject a specific payment made by means of a credit transfer (A/CN.9/328, para. 38). In reply it was pointed out that some States had tax laws that required commercial payments to be made by cheque, credit transfer or other similar means, while many other States had statutory provisions similar to paragraph (1) (para. 40).

*Paragraph (2)*

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

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

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

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

7. The Working Group may wish to consider whether paragraph (2) might be re-worded as follows in order to satisfy the concerns noted above:

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

8. Under yet another approach the question of discharge of an obligation might be affected without stating a specific rule by the following text:

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

*Paragraph (3)*

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

*Paragraph (4)*

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

## CHAPTER V. CONFLICT OF LAWS

Article 15. *Conflict of laws*

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

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

obligation, the law of the State where the beneficiary's bank is located governs the mutual rights and obligations of the originator and the beneficiary.

*Prior discussion*

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

A/CN.9/317, para. 165

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

*Comments*

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

2. The problem of conflict of laws is considered in more detail in the report of the Secretary-General to the nineteenth session of the Working Group, A/CN.9/WG.IV/WP.42, paras. 69 to 80. That report considers the issues especially in light of the decisions of the Working Group at its eighteenth session that the text under preparation should be in the form of a model law for adoption by national legislative bodies and that it should be restricted to international credit transfers.

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

## II. PROCUREMENT

### A. Report of the Working Group on the New International Economic Order on the work of its eleventh session (New York, 5-16 February 1990) (A/CN.9/331) [Original: English]

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## INTRODUCTION

1. At its nineteenth session in 1986, the Commission decided to undertake work in the area of procurement as a matter of priority and entrusted that work to the Working Group on the New International Economic Order.<sup>1</sup> The Working Group commenced its work on this topic at its tenth session, held at Vienna from 17 to 25 October 1988, by considering a study of procurement prepared by the Secretariat.<sup>2</sup> The Working Group requested the Secretariat to prepare a first draft of a model law on procurement and an accompanying commentary taking into account the discussions and decisions at the session.<sup>3</sup>

2. The Commission, at its twenty-second session in 1989, expressed appreciation for the work performed by the Working Group so far and requested it to proceed with its work expeditiously.<sup>4</sup>

3. The Working Group, which was composed of all States members of the Commission, held its eleventh session in New York from 5 to 16 February 1990. The session was attended by representatives of the following States members of the Working Group: Argentina, Bulgaria, Cameroon, Canada, Chile, China, Czechoslovakia, Denmark, Egypt, France, Germany, Federal Republic of, Hungary, India, Iraq, Iran (Islamic Republic of), Japan, Kenya, Lesotho, Mexico, Morocco, Netherlands, Spain, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United States of America, Uruguay, and Yugoslavia.

4. The session was attended by observers from the following States: Afghanistan, Angola, Burkina Faso,

Colombia, Ecuador, El Salvador, German Democratic Republic, Holy See, Jordan, Liberia, Libyan Arab Jamahiriya, Oman, Paraguay, Philippines, Republic of Korea, Switzerland, Turkey, Uganda, United Republic of Tanzania, Vanuatu.

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

(a) *United Nations organizations*: International Bank for Reconstruction and Development, United Nations Development Programme;

(b) *Intergovernmental organizations*: Asian-African Legal Consultative Committee, Commission of the European Communities, Inter-American Development Bank;

(c) *International non-governmental organizations*: International Chamber of Commerce.

6. The Working Group elected the following officers:

*Chairman*: Mr. Robert Hunja (Kenya)

*Rapporteur*: Mr. Jan de Boer (Netherlands)

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

(a) Provisional agenda (A/CN.9/WG.V/WP.23);

(b) Procurement: draft model law on procurement (A/CN.9/WG.V/WP.24);

(c) Procurement: commentary on draft model law on procurement (A/CN.9/WG.V/WP.25).

8. The Working Group adopted the following agenda:

(a) Election of officers.

(b) Adoption of the agenda.

(c) Procurement.

(d) Other business.

(e) Adoption of the report.

<sup>1</sup>Report of the United Nations Commission on International Trade Law on the work of its nineteenth session, *Official Records of the General Assembly, Forty-first Session, Supplement No. 17 (A/41/17)*, para. 243.

<sup>2</sup>A/CN.9/WG.V/WP.22.

<sup>3</sup>A/CN.9/315, para. 125.

<sup>4</sup>*Official Records of the General Assembly, Forty-fourth Session, Supplement No. 17 (A/44/17)*, paras. 232 and 235.

## DELIBERATIONS AND DECISIONS

### I. General discussion

9. The observer for the Commission of the European Communities informed the Working Group of developments within the European Communities (EC) directed towards the opening up of public procurement within the EC, which was one of the major elements in the creation of the single internal market within the EC. The EC had recently adopted new directives on the procurement of works and on the procurement of supplies, as well as a directive dealing with remedies. In addition, a directive on the procurement of services was under preparation. Work was also in progress on a proposal to include within the scope of the EC procurement directives entities that had hitherto been excluded.

10. The observer for the Asian-African Legal Consultative Committee proposed that the model law on procurement provide for the resolution of disputes arising from procurement through conciliation and arbitration. The provision should be flexible so as to enable implementing States to determine which types of disputes could be submitted for resolution by those means. Further, the model law should provide for the use of the UNCITRAL Arbitration Rules or the UNCITRAL Conciliation Rules where the parties to the arbitration or conciliation proceedings did not agree to use some other rules.

11. During the general discussion, it was noted that, as currently drafted, the model law did not deal with certain issues that were addressed in the General Agreement on Tariffs and Trade (GATT) Agreement on Government Procurement, such as most-favoured-nation treatment, national treatment and special treatment for developing countries. It was suggested that the model law on procurement cover those issues in order to be consistent with the GATT Agreement on Government Procurement and in order to provide uniform rules as to those issues. In response, it was observed that the nature and scope of the model law, which was a model for national legislation, differed from that of the GATT Agreement on Government Procurement, which was a multilateral agreement, and that the model law sought to take account of the needs and interests of developing countries in various ways that were appropriate for its particular nature and scope.

12. A view was expressed that the model law as currently drafted was too complex, which made it difficult to understand and to use. Various proposals for dealing with that problem were made in the context of the discussion on particular articles. Another view was expressed that it would be preferable for the provisions of the model law to be constituted in the form of rules for voluntary use by a procuring entity or in the form of guidelines. That view did not receive support.

13. The Working Group endorsed the decision taken at its tenth session that the model procurement law should be accompanied by a commentary. Various views were expressed concerning the nature and status of the commentary and its relationship to the model law. It was generally agreed that, although both instruments would be

adopted by the Commission, they would not have the same juridical status. The model law would set forth normative legal rules governing procurement and would be capable of existing independently of the commentary. The commentary would not have a normative legal character; rather it would serve to complement and facilitate the use of the model law.

14. It was noted that, as currently drafted, the commentary performed that role in various ways. Some portions of the commentary provided guidance for the interpretation of provisions of the model law; other portions provided guidance to States in enacting the model law and in promulgating supplementary procurement regulations; yet other portions provided guidance to procuring entities and to contractors and suppliers in using the model law. Significant support was expressed for that multifarious approach, since it made the commentary useful to the various categories of persons and entities involved in procurement and promoted the uniform interpretation and application of the model law.

15. Various other views were expressed, however, concerning the functions and structure of the commentary. According to one such view it was inappropriate for the commentary to interpret provisions of the model law. Another view was that it would be more appropriate for the guidance offered by the commentary to States in enacting the model law and in promulgating supplementary regulations to be contained in the text of the model law itself. It was also observed that some portions of the commentary might be designed to have lasting significance and applicability after the model law had been enacted (e.g., those portions providing guidance to the interpretation of the model law), while others might be regarded to have served their purpose completely once the model law had been enacted (e.g., those portions offering guidance to States in enacting the model law).

16. The Working Group decided that it would not at the current stage take final decisions as to the functions or structure of the commentary. However, it would pay attention to the contents of the commentary during its examination of the articles of the model law. It would, in particular, seek to ensure that the commentary was consistent with the provisions of the model law and to eliminate from the commentary alternative approaches to the settlement of issues in the model law when a particular approach had been decided upon.

### II. Discussion of articles of draft model law on procurement

#### Article 1

#### Application of law

17. A suggestion was made that the reference to "such means as purchase, rental or otherwise" be re-examined to ensure that it adequately covered the various means by which goods were procured.

18. With respect to the second sentence in article 1, according to which the model law applied even if services

were involved in the procurement as long as goods or construction constituted a "substantial part" of the procurement, a preference was expressed for the formulation used in the GATT Agreement on Government Procurement. That formulation covered "incidental services" where the value of those services did not exceed the value of the goods or construction. In support of that view, it was noted that, under the formulation currently used in the model law, an implementing State could restrict the scope of application of the model law by defining "substantial part" narrowly. A related proposal was made during the discussion of the definition of "construction" under article 2 (see paragraph 24, below).

19. According to a further proposal, the scope of the model law should be expanded to cover the procurement of consulting services and other types of services, since it was important for States to have an adequate legal framework for the procurement of those services. In opposition to the proposal, it was noted that the treatment of services was currently under discussion within GATT and any decision to enlarge the scope of the model law to cover services, other than those that were incidental to goods or construction being procured, should await the outcome of those discussions.

20. After some deliberation it was generally agreed that the Working Group would, at the current stage, prepare rules covering the procurement of goods and of construction, dealing also with services that were incidental or related to the procurement of goods or construction. The Working Group noted that the question of whether the model law should cover consulting services and other types of services could be addressed at a later stage.

## *Article 2*

### *Definitions*

21. A proposal was made that the definitions be deleted from the model law on the grounds that a large number of definitions would make the text difficult to read and that definitions were not necessary because the terms covered by the definitions could be described in the commentary. That proposal did not receive sufficient support.

22. A suggestion was made that article 2 be relocated to appear as article 1.

23. Various proposals were made with respect to the content of the definitions set forth in article 2. Concerning the definition of "procuring entity", a view was expressed that, when a State enacted the model law, it should indicate clearly not only those entities that were covered by the model law but also those that were not covered. According to another view, the definition of "goods" should be made more flexible so as to accommodate the procurement of items such as water, gas and electricity. It was further suggested that the international element in the term "international tendering proceedings" be more clearly defined. In that connection, the approach adopted in the UNCITRAL Model Law on International Commercial Arbitration (article 1(3)) was suggested as a model.

24. A suggestion was made that the definition of "construction" be broadened to cover activities analogous to construction, for which precise specifications could be prepared and which could be procured essentially on the basis of the price of the activities. They included, for example, drilling for water and gas, mapping, satellite photography and seismic studies procured in conjunction with construction projects. It was also suggested that the definition of construction include demolition.

25. It was proposed that the definition of "tender security" include a reference to surety bonds. It was also suggested that the definition refer to issuers of tender securities by using a term broader than "banks", such as "financial institutions". A further suggestion was that the definition point out that the purpose of a tender security was to secure the obligation of the tenderer to sign a contract in the event his tender was accepted.

26. It was suggested that the definition of "competitive negotiation proceedings" state explicitly that the term referred to a procedure involving negotiations on a competitive basis between a procuring entity and at least two bidders.

27. Suggestions were made that the model law provide definitions for a number of additional terms used in the model law, such as "procurement", "procurement proceedings", "responsive tender", "procurement regulations" and "tendering proceedings".

28. It was further suggested that the term "bid solicitation documents" be substituted for the term "procurement documents" that was used in various provisions of the model law, in order to distinguish clearly between the documents contained in a solicitation of tenders by a procuring entity and the documents submitted by a contractor or supplier as part of its tender.

29. The Working Group noted the various suggestions that had been made and requested the Secretariat to consider whether and how to implement them in the preparation of the next draft of the model procurement law.

## *Article 3*

### *Underlying policies*

30. Proposals were made that paragraph (1) be relocated to the beginning of the model law, either as a preamble or as the first article. With respect to the wording of that paragraph, a suggestion was made that the term "policies" be replaced with "purposes" or "objectives", in order to conform to usage in legislation.

31. It was proposed that the reference to maximizing efficiency in procurement (para. (1)(a)) be relocated from its current position to the end of the paragraph, and that the reference be reworded so as to provide that all of the objectives currently set out in paragraph (1)(b) through (f) be "consistent with the efficient operation of the procurement system". A related view was that the reference in

paragraph (1)(a) to maximizing economy in procurement might be superfluous in view of the policy mentioned in paragraph (1)(c) of promoting competition among contractors and suppliers.

32. A proposal was made that subparagraph (2) be deleted on the ground that the model law should not address questions of hierarchy of law. In response to that proposal, it was stated that a provision in the model law clearly establishing the relationship of the model law to international obligations of the enacting State, including State practice under multilateral and bilateral treaties and including agreements with international financing institutions, would be of considerable practical value; it would enable procuring entities, faced with a conflict between the model law and an international obligation, to determine which to apply. It was also pointed out that such a provision could be useful from the standpoint of unification of law, because not all legal systems recognized the supremacy of international obligations over national legislation.

33. There was widespread support for retaining a provision along the lines of paragraph (2), subject, however, to improving the drafting so as to clarify that, if there was a conflict between a provision in the model law and the requirements of an international obligation, the requirements of the international obligation were to be applied; but in all other respects, the procurement was to be governed by the model law.

#### Article 4

##### *Procurement regulations*

34. A view was expressed that article 4 should be expanded so as to call upon the implementing State to identify in the article not only the organ authorized to promulgate procurement regulations, but also organs authorized to promulgate administrative rulings, directives or guidelines under the model law. That would help contractors and suppliers to become aware of legal requirements to which they might be subject. An opposing view was that the suggested expansion of the article would go too far. It was noted that, in some States, several organs might be empowered to issue various types of directives, rulings and guidelines relating to procurement. According to another view, it would be sufficient to alert contractors and suppliers to the possible existence of administrative directives, rulings and guidelines by defining "procurement regulations" as including such texts. After discussion, it was agreed that article 4 be retained in its current form, but that mention be made in the commentary that, in addition to the model law, various types of directives, rulings and guidelines might be applicable in particular procurement proceedings.

#### Article 5

##### *Public accessibility of procurement law, procurement regulations and other legal texts relating to procurement*

35. Views were expressed in support of the recommendation contained in paragraph 2 of the commentary to this

article that implementing States collect and issue in a single publication the laws, regulations and other legal texts relating to procurement in those States. Contrary views were expressed that such a requirement would not be practical.

#### Article 6

##### *Control and supervision of procurement*

36. In connection with paragraph (1), it was noted that the necessity for the procuring entity to obtain approval of an action or decision, and the organ that was to give the approval, might vary depending on the action or decision in question. The view was accordingly expressed that the paragraph was unsatisfactory in the current form, as it treated all cases of approval in an identical manner. As a means of remedying that situation, a proposal was made that the paragraph be deleted, and that each provision of the model law requiring approval of an action or decision set out the circumstances in which the approval must be sought and identify the organ that was to give the approval. It was observed, however, that the proposal would complicate the drafting of the model law. Another view was that, rather than requiring approval of a higher authority as a means of ensuring the conformity of an action or decision with the model law, the model law should set forth precise rules and criteria for taking the action or decision so as to minimize the possibility of misapplication or abuse.

37. An observation was made that paragraph (2) seemed to involve a degree of centralization of control and supervision over procurement that might not be regarded as desirable in some countries.

38. A view was expressed that, as the questions dealt with by article 6 were related to the issue of redress and remedies, further consideration of the article should be deferred until the Working Group considered that issue. The Working Group decided to take note of the views that had been expressed and to postpone reaching final decisions concerning the questions that had been raised.

#### Article 7

##### *Methods of procurement and conditions for their use*

39. Support was expressed for the alternative approach to article 7 that was described in paragraph 1 of the commentary to the article. Under that approach, the procuring entity would be free to decide which method of procurement to use in a particular case. The prevailing view, however, favoured the approach currently reflected in the text of article 7, under which tendering was the preferred method of procurement and methods other than tendering could be used only in specified circumstances. The possibility of presenting both approaches to implementing States, which would choose the alternative that they preferred, was also mentioned.

40. With respect to the threshold values provided for in paragraphs (2) and (3), a view was expressed that reference should be made to the estimated value of the pro-



curement contract rather than to the price of the contract, since the price would not be known when the decision as to which procurement method to use would be made. A contrary view was that the threshold values should be set forth in the model law itself, rather than in the procurement regulations, since some States might not promulgate such regulations.

41. Providing for procurement by competitive negotiation proceedings, as they were conceived in the current text of the model law, was said to be dangerous, as the ability of the procuring entity to negotiate confidentially with several contractors and suppliers simultaneously could lead to abuse and corruption. The prevailing view, however, was that it was desirable to provide for competitive negotiation proceedings for cases where tendering was not a suitable method of procurement.

42. There was, however, significant support for expanding the circumstances in which competitive negotiation proceedings could be used. It was proposed that, in addition to the circumstances currently mentioned in paragraph (2), competitive negotiation proceedings be permitted where it was not possible to formulate specifications for the goods or construction to be procured with the precision necessary to engage in tendering proceedings; where the procuring entity sought proposals for the most advanced or the most appropriate technology; where only one responsive tender had been submitted; and where the prices of submitted tenders did not result in fair value to the procuring entity. Similarly, there was significant support for expanding the circumstances in which single-source procurement could be used. It was proposed that, in addition to the circumstances currently mentioned in paragraph (3), single-source procurement be permitted where necessary to promote national socio-economic objectives; where a particular contractor or supplier had exclusive rights to the desired technology; where it was necessary to develop a particular source of supply for strategic reasons; and in cases of additional deliveries by the original supplier or where the scope or volume of a procurement requirement exceeded the normal capacity of the industry so that special facilities would have to be built by the contractor or supplier deemed to be the one with the most related experience. (See, also, paragraph 182, below.)

43. The Working Group engaged in further consideration of article 7(2) and 7(3) during its consideration of article 34. The discussion of the Working Group in that connection is set forth in paragraphs 213, 214 and 219, below.

44. It was stated that the reference to the need for secrecy in paragraph (3)(f) could defeat transparency and that reference should be made instead to the protection of national security and to national defence.

#### Articles 8 and 9

##### *Eligibility and qualifications of contractors and suppliers*

45. It was generally agreed that article 8 and article 9 be merged, as the subject-matter of both articles was essen-

tially the same, namely, the assessment by the procuring entity of the suitability of contractors and suppliers to perform the contract. In consequence of that decision, it was proposed that the word "eligibility" be deleted from the text of the model law. An opinion was expressed that the relevance of the articles would be diminished where the goods or construction needed by the procuring entity was available only from a single source, since the procuring entity would have no alternative other than to procure from that source.

46. It was generally agreed that the right of the procuring entity to require contractors and suppliers to submit information to establish their qualifications be subject to the right of contractors and suppliers to protect their legal interests in proprietary technology or other intellectual property.

47. It was proposed that the reference to "written statements" be deleted from the *chapeau* of article 8(1)(a), from article 9 and from other provisions in the text, since that term was covered by the term "documentary evidence".

48. Various proposals were made with respect to the criteria set forth in paragraph (1)(a) of article 8. A view was expressed that the law of the State of the contractor's or supplier's nationality should be relevant for establishing the legal capacity of a contractor or supplier to conclude a procurement contract. It was suggested that a reference to receivership be added to paragraph (1)(a)(ii).

49. A proposal was made that paragraph (1)(a)(iv) of article 8 be deleted on the ground that problems could arise in applying that provision, for example, in relation to a contractor or supplier that had been convicted of a crime but had later been granted a pardon. Another proposal was that the provision be retained and that a criterion be added to the effect that the contractor or supplier must not have been held liable for damages in civil proceedings within the preceding five years.

50. It was generally agreed that paragraph (1)(a)(v) of article 8, in which the implementing State could insert additional criteria, be deleted, since some criteria that might be added could be inconsistent with the underlying policies of the model law, and since the addition of differing criteria by various States would be counter-productive to the objective of uniformity of law.

51. A proposal was made that paragraph (1)(b) of article 8 include a specific reference to the right of the procuring entity to inspect the books of the contractor or supplier.

52. It was generally agreed that a provision along the lines of paragraph (3) of article 8, which appeared within square brackets in the current draft of the model law, be retained. That provision enabled a contractor or supplier to participate in procurement proceedings under certain conditions even if it had not yet conformed to the required criteria. A proposal was made that the contractor or supplier be required to establish its conformity with the criteria by a specified time. A further proposal was that the right of the contractor or supplier to participate in the

procurement proceedings be made subject to the efficient operation of the procurement system, as such a provision would bring the model law in line with the GATT Agreement on Government Procurement.

53. The content of article 9 was regarded as broadly acceptable, subject to possible additions and improvements. Proposals were made that additional criteria relating to the qualifications of contractors and suppliers be referred to, including managerial capability, reliability, experience and reputation. Another proposal was that the article specify that a contractor or supplier would be disqualified if it had been found guilty by a competent court or tribunal of a serious misrepresentation in its submissions to the procuring entity regarding its qualifications or its products.

54. It was generally agreed that the criteria that were to be applied in any procurement proceedings should relate to the suitability of contractors and suppliers to perform the particular procurement contract that was to result from those proceedings.

#### *Article 10*

##### *Rules concerning written statements and documentary evidence provided by contractors and suppliers*

55. Questions were raised as to the usefulness and desirability of article 10. It was observed that, since the provisions of the article relating to the attestation and acceptability of documentary evidence referred to national law, they served little purpose and did not contribute to uniformity of law. Moreover, the requirement that documentary evidence be solemnized before and attested to by a notary or other competent authority was only of limited usefulness, since the notary or other authority could verify only the identity of the signer of the document, and not the accuracy of its contents.

56. The article as it currently appeared was said to be too strict and rigid because it required the formalities to legalize documents in all cases, whereas in some cases those formalities might be unnecessary. It was noted that the time that it could take to comply with the formalities could prevent contractors and suppliers from submitting tenders on time. Accordingly, it was generally agreed that, if article 10 were to be retained, it should provide rules only for cases where the procuring entity required that documents be legalized.

#### *Article 11*

##### *International tendering proceedings*

57. The substance of paragraph (1), under which the procuring entity could decide to engage in international tendering proceedings, was found to be generally acceptable. It was generally agreed, however, that the meaning of "international tendering proceedings" required clarification.

58. With respect to paragraph (2), it was generally agreed that international tendering proceedings should not be mandatory. Rather, the article should alert the procuring entity that international tendering proceedings were desirable in some cases, e.g., where the goods or construction to be procured were of a high value, where the goods or construction were not available domestically or where there existed no competition among domestic contractors and suppliers.

59. A proposal was made that paragraph (2) be reformulated so as to require that, when the estimated value of the procurement contract exceeded a specified amount, the procuring entity must solicit tenders from the maximum number of domestic and foreign contractors and suppliers consistent with the efficient operation of the procurement system. The proposal was said to be a means of bridging the gap between those who favoured making international tendering proceedings mandatory when the value of the procurement exceeded a threshold amount and those who opposed making international tendering proceedings mandatory.

#### *Article 12*

##### *Solicitation of tenders and applications to prequalify*

60. With respect to paragraph (1), it was proposed that provision be made for solicitation of tenders by means of electronic transmission, and even by telephone in appropriate cases (e.g., in cases of urgency or where the value of the goods or construction to be procured was low).

61. It was observed that the restricted tendering procedures provided for in paragraph (2) provided an important safety valve for the procuring entity by enabling it to exclude contractors and suppliers that it did not regard as appropriate to perform the contract. It was suggested that the paragraph indicate clearly the types of circumstances in which a procuring entity would be entitled to resort to restricted tendering, perhaps by incorporating the considerations mentioned in paragraph 2 of the commentary. Another proposal was that the words "notwithstanding the provisions of paragraph (1)" be inserted at the beginning of paragraph (2) in order to reduce the possible appearance of an inconsistency between paragraphs (1) and (2).

#### *Article 13*

##### *Lists of approved contractors and suppliers*

62. The Working Group decided to delete article 13 for the following reasons. The use of lists of contractors and suppliers for the solicitation of tenders was diminishing and, in any event, should not be encouraged because the lists could be used in a manner that would unfairly discriminate against particular contractors and suppliers. Moreover, the article as currently drafted contained some uncertainties and ambiguities, such as whether or not, when a list existed, tenders could be solicited from contractors and suppliers that were not on the list; whether or not tenders must be solicited from all contractors and suppliers on the list; and whether or not the list had to be

used at all for the solicitation of tenders. If the list did not have to be used, or if tenders could be solicited from contractors and suppliers that were not on the list, the necessity for and usefulness of article 13 was questionable. However, the Working Group agreed that it would be useful to include in the commentary to the model law some discussion of the use of the lists of approved contractors and suppliers.

63. In favour of retaining the article, the view was expressed that, if appropriately modified, the article could serve to eliminate uncertainty as to whether or not a procuring entity could employ such lists. In addition, it was said that the article could contribute to fairness and transparency in connection with the use of the lists.

#### Article 14

##### *Contents of notice of proposed procurement*

64. The Working Group considered that article 14 was largely satisfactory, subject to the following improvements. In paragraph (1), it should be clarified that the specified information to be included in the notice of proposed procurement was only the required minimum. That clarification might be accomplished by inserting the words "at least" after "contain" in the *chapeau* of the paragraph. The paragraph should also require the notice of proposed procurement to state if a tender security was required and the nature and amount of the security, the criteria to be used for assessing the qualifications of contractors and suppliers, and the right of aggrieved contractors and suppliers to seek redress for a failure by the procuring entity to comply with the procurement law or regulations.

65. A suggestion, which was not accepted, was made either to delete or to modify the statement in the *chapeau* of paragraph (2) which was to the effect that, when prequalification proceedings were to be engaged in, the notice of proposed procurement need not contain information as to how, where and in what languages the procurement documents could be obtained. It was noted that the information would not be needed when prequalification proceedings were used because, pursuant to article 17, the procurement documents would be provided automatically to contractors and suppliers that were prequalified.

#### Article 15

##### *Assessment of qualifications of contractors and suppliers*

66. The Working Group noted that article 15 contained rules to implement, in the context of tendering proceedings, the general principles set forth in article 9 concerning the qualifications of contractors and suppliers. It was suggested that the duplication that existed between article 9 (which, as previously decided, would be merged with article 8; see paragraph 45, above), and article 15 be avoided by consolidating those articles. In addition to reducing duplication, such a consolidation would make the model law easier to understand and apply and would avoid inconsistencies.

67. Views were expressed that certain terms used in article 15 and in the commentary required clarification, including "assess" (used in paragraph (1)), "unduly" (used in paragraph (3)), "evaluation of qualifications" (used in paragraph 1 of the commentary) and "minimum thresholds of acceptability" (used in paragraph 1 of the commentary).

68. A proposal was made that the qualification criteria listed in paragraph (2) be expanded to include the experience of contractors and suppliers, their past performance of similar contracts and their capabilities with respect to personnel and equipment. Another proposal was that reference be made to the technical, commercial, legal, financial and managerial competence of contractors and suppliers.

69. According to another proposal, it should be clarified, perhaps in the commentary, that paragraph (3) was directed both to discrimination against foreign contractors and suppliers in general and to discrimination among classes of foreign contractors and suppliers.

70. It was agreed that article 15 should contain an express reference to postqualification proceedings. Those proceedings were said to be necessary in order to reconfirm, at the time of acceptance of a tender, the qualifications of a contractor or supplier that had been prequalified, when there was a significant time lag between the prequalification proceedings and the time of acceptance of a tender. It was also agreed that only the qualifications of the contractor or supplier whose tender had been accepted should be reconfirmed in postqualification proceedings. (See, also, paragraph 78, below.)

71. It was agreed that the sentence, "In some cases where contractors and suppliers have been prequalified, their qualifications may be assessed more closely after the opening of tenders", be deleted from paragraph 1 of the commentary, since the qualifications of a contractor or supplier that had been prequalified should not be examined again until postqualification proceedings.

#### Article 16

##### *Prequalification proceedings*

72. It was suggested that the article make it clear that a contractor or supplier that had not participated in prequalification proceedings could not submit a tender.

73. A suggestion was made that the meaning of the opening words of paragraph (1) be clarified to the effect that, when restricted tendering proceedings were used, prequalification proceedings were not held, in order to avoid a possible implication that the qualifications of contractors and suppliers were not to be examined at all in restricted tendering proceedings.

74. It was observed that certain types of information required by paragraph (3) to be included in the prequalification documents were also required by article 14 to be included in the notice of proposed procurement. That duplication was said to be desirable because the notice of proposed procurement and the prequalification documents

served different purposes, and it was useful to contractors and suppliers for the information to be contained in both locations.

75. A proposal was made that paragraph (3)(b) be deleted, since the requirement contained in that provision was expressed in vague and general terms and would thus have little practical effect.

76. It was generally agreed that paragraph (3)(h) be deleted, and that the paragraph provide instead that the procuring entity must be prepared on request to explain the procurement practices and procedures to any contractor or supplier.

77. In connection with paragraph (4), the view was expressed that the names of contractors and suppliers that had been prequalified should be made public only after a tender had been accepted.

78. It was generally agreed that paragraph (6) be re-drafted so as to require the procuring entity to reconfirm in postqualification proceedings the qualifications of the contractor or supplier whose tender had been accepted. Furthermore, the criteria to be used for that postqualification should be the same as those used in the prequalification proceedings, and should be set forth in the procurement documents. It was also agreed that the paragraph provide what was to occur if the contractor or supplier whose tender had been accepted was found in postqualification proceedings no longer to meet the qualification criteria (e.g., provide that the next lowest tender was to be accepted or that new procurement proceedings were to be engaged in). (See, also, paragraph 70, above.)

#### Article 17

##### *Provision of procurement documents to contractors and suppliers*

79. The Working Group found the substance of article 17 to be acceptable.

#### Article 18

##### *Contents of procurement documents*

80. A view was expressed that the article should identify which portions of the procurement documents and which information contained in those documents were to become part of the procurement contract.

81. It was observed that several subparagraphs of the article referred to issues that were dealt with elsewhere in the model law. A proposal was made that cross-references be included in those subparagraphs in order to facilitate the use and understanding of the model law.

82. A proposal was made that the word "all" be deleted from the *chapeau* of the article since the requirement that all necessary information be provided could give rise to disputes if an item of information claimed to be necessary were to be omitted from the procurement documents.

83. A proposal was made that the *chapeau* of the article be expanded so as to require the procurement documents to contain not only information necessary for the submission of responsive tenders but also the rules governing the opening, examination and evaluation of tenders.

84. It was observed that certain types of information required by article 18 to be included in the procurement documents were also required by article 14 to be included in the notice of proposed procurement. That duplication was said to be desirable because the notice of proposed procurement and the procurement documents served different purposes, and it was useful to contractors and suppliers for the information to be contained in both locations.

85. A suggestion was made that subparagraph (e) employ any relevant wording used in the UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works.

86. A proposal was made that subparagraph (f) specifically require the procurement documents to include information as to the law applicable to the contract and the means of settling disputes under the contract.

87. It was suggested that subparagraph (g) refer not only to alternative tenders that were solicited, but also to alternative tenders that were permitted.

88. A proposal was made that subparagraph (i) specifically require the procurement documents to include information as to the pricing terms of the contract (e.g., unit price; lump sum), as to whether or not taxes, customs duties and similar charges and levies were to be included in the contract price, and as to which party was to bear the risk of higher costs resulting from changes in laws relating to taxes, customs duties and similar charges and levies and from changes in other laws affecting the performance of the contract. (See paragraph 114, below.)

89. It was agreed that subparagraph (j) be deleted because it was not in the interests of the procuring entity to establish a maximum price, a minimum price or a range of prices. (See, also, paragraph 182, below.)

90. A proposal was made in connection with subparagraph (m) that the procurement documents indicate whether and under what conditions the procuring entity would consider tenders submitted late.

91. It was proposed that subparagraph (n) be altered so as to refer to a meeting of contractors and suppliers "that may be convened" by the procuring entity.

92. In the context of subparagraph (p), there was said to be a danger that terms such as "most advantageous tender" and "evaluate" could be misinterpreted as giving the procuring entity too much discretion with respect to the choice of a tender, notwithstanding the fact that "most advantageous tender" was defined in article 28(7)(c). It was proposed that wording be employed that avoided the possibility of such a misinterpretation. In that connection, the view was expressed that a tender should be chosen on

the basis of price and other objective and quantifiable criteria. According to another view, however, that approach was too strict, as it would prevent a procuring entity from taking into account other legitimate criteria, which were not easily quantifiable, such as socio-economic factors in the country of the procuring entity. Apart from those differing views, it was agreed that the procurement documents should set forth all criteria that would be taken into account by the procuring entity in choosing a tender.

93. Views were divided with respect to subparagraph (s). Several arguments were advanced in favour of retaining the subparagraph, including its reference (set forth within square brackets) to various types of laws and regulations pertinent to the performance of the contract. It was observed that it was important for contractors and suppliers to be aware of laws and regulations pertinent to the tendering proceedings and to the performance of the contract. There often existed a variety of types of pertinent laws and regulations, and without a provision of the nature of subparagraph (s) it would often be difficult for contractors and suppliers to become aware of them. Foreign contractors and suppliers, and those that had no previous experience with public sector tendering proceedings in the implementing State, would be at a particular disadvantage. It was stated that the subparagraph did not impose an undue burden on the procuring entity, since it required only that references be given to the pertinent laws and regulations; it did not require the procuring entity to provide the contents or an analysis of the laws and regulations. It was further observed that the subparagraph could be beneficial not only to contractors and suppliers, but also to the procuring entity, since the provision would contribute to the efficient conduct of the tendering proceedings and would help ensure that the performance of the procurement contract was in compliance with pertinent laws and regulations.

94. Several arguments were advanced in opposition to the subparagraph. It was stated that it was inappropriate to require the procuring entity to give legal advice to contractors and suppliers. Rather, contractors and suppliers should be expected to obtain their own competent professional legal advice in the ordinary course of doing business. The requirements of subparagraph (s) were said to be excessively burdensome because the laws and regulations pertinent to tendering proceedings and to the performance of the contract were sometimes numerous and complex. In that regard, it was also pointed out that particular problems arose in countries with federal systems where various aspects of the procurement proceedings and of the performance of the procurement contract could be subject to national laws as well as to laws of subdivisions of the federation; it was sometimes difficult to ascertain which of those laws would apply. It was further stated that merely requiring the procuring entity to give references to the pertinent laws and regulations was of little benefit to contractors and suppliers, who would require advice as to the content, meaning and application of the law and regulations.

95. A view was expressed that the appropriateness of the subparagraph depended to some extent on the conse-

quences that would accrue if a reference to a particular law or regulation was incorrect or was omitted from the procurement documents. One view was that, in such a case, the procuring entity should bear legal responsibility for such errors or omissions. For example, in appropriate cases, the contractor or supplier whose contract had been accepted and who incurred increased costs in the performance of the contract due to an error or omission should be entitled to an adjustment of the contract price. With respect to that point, however, it was stated that the question of price adjustment should be dealt with in the contract, and not in the model procurement law. Another view was that, if the subparagraph were to be retained, the procuring entity should bear no legal responsibility for an erroneous reference to or an omission of a law or regulation. With respect to that point, however, it was observed that an exoneration from liability would, in cases of gross negligence, be inconsistent with policy in some legal systems.

96. As a means of making the requirements of the subparagraph less onerous for the procuring entity, a proposal was made that the subparagraph be redrafted so as not to require the procuring entity to provide an exhaustive list of pertinent laws and regulations. A further proposal was that subparagraph (s) be reformulated so as to require the procuring entity to be prepared on request to explain the procurement practices and procedures to any contractor or supplier. It was observed, however, that the proposed formulation went beyond merely providing references to the pertinent laws and regulations, and thus could impose a more onerous obligation on the procuring entity than the current formulation of the subparagraph. Yet another proposal was that a distinction be drawn between the two types of laws and regulations currently referred to in the subparagraph, by obligating the procuring entity to provide references to laws and regulations pertinent to the tender proceedings and to bear responsibility for an error in or omission of a reference, but taking a less strict approach with respect to laws and regulations relating to the performance of the contract.

97. The trend of the discussion was to the effect that the current formulation of subparagraph (s) imposed too onerous a burden on the procuring entity. The Secretariat was requested to reformulate the subparagraph for the next draft of the model procurement law on the basis of the discussion.

98. With respect to subparagraph (t), it was agreed that an express provision be added to the effect that contractors and suppliers be able to communicate directly with the procuring entity without going through an intermediary.

99. It was agreed that article 18 require the following additional information to be included in the procurement documents: any countertrade obligations imposed by the procuring entity, the organ or organs responsible for exercising supervision and control over procurement, and the right of contractors and suppliers to redress for a failure by the procuring entity to conform to the procurement law and regulations.

**Article 19*****Charge for procurement documents***

100. A view was expressed that the article should be redrafted so as to provide that the charge for the procurement documents may not exceed the cost of printing the documents and distributing them to contractors and suppliers. According to another view, however, the article was satisfactory in its current form, which provided that the charge "shall reflect" the printing and distribution costs, since it was not practicable to require the procuring entity to calculate precisely the costs of printing and distributing the documents.

101. A question was raised as to whether, under the current formulation of the article, the procuring entity could include in the charge for the procurement documents any taxes imposed on the procuring entity in connection with printing the documents.

102. A proposal was made that the words "excessively high charges", which appeared in the commentary, be reconsidered, since those words could suggest that factors other than the cost of printing and distributing the procurement documents could be taken into account in setting the charge.

**Article 20*****Rules concerning formulation of prequalification documents and procurement documents***

103. It was suggested that the title of the article be redrafted so as to indicate more clearly the subject-matter dealt with in the article.

104. It was observed that paragraph (1) was of a preambular, rather than normative, character and thus was of questionable utility in its current form.

105. A view was expressed that the first reference in paragraph (1) to obstacles to participation by contractors and suppliers in tendering proceedings should be modified so as to refer to "unnecessary" obstacles.

106. A view was expressed that an attempt should be made to draft paragraph (3) more concisely.

107. Support was expressed for the requirement in paragraph (3)(c) that international standards be used where available. According to another view, however, the procuring entity should be able to depart from international standards in certain circumstances, i.e., when those standards were incompatible with existing equipment or when the procuring entity wished to obtain a particular technology. A further proposal was that the procuring entity should use international standards except when they were inconsistent with or less stringent than national standards.

108. The prevailing view, however, was that no preference should be accorded to international standards and

that the procuring entity should have the flexibility to use whichever standards it considered to be more appropriate for a particular procurement. In that connection, it was noted that countries varied in their ability to adapt to international standards.

109. With respect to paragraph (4), a view was expressed that the requirement that, in international tendering proceedings, the procurement documents and the prequalification documents must be formulated in a "language customarily used in international trade" was imprecise and could lead to disputes as to whether the language used in a particular case was one customarily used in international trade. The possibility was raised of specifying in the model law which languages could be used (e.g., official languages of the United Nations).

110. A view was expressed that it was excessively burdensome to require the procuring entity to prepare two sets of documents, one in an official language of its country and the other in a language customarily used in international trade. It was stated that the procuring entity should be able to issue the documents in only one of those languages.

111. A view was expressed that the rule set forth in the last sentence of the paragraph that, in the event of a conflict between language versions, the version in the language customarily used in international trade shall prevail, would be difficult for some implementing States to accept and would not necessarily be followed by courts in all countries.

**Article 21*****New or amended laws or regulations relating to taxes, customs duties or similar charges, or affecting performance of procurement contract***

112. In connection with its consideration of the article, the Working Group also considered paragraph 6 of the commentary to article 18.

113. Support was expressed for article 21, under which the procuring entity was to bear any extra costs incurred by the contractor or supplier in performing the contract due to new laws or regulations of the State of the procuring entity or due to changes in existing laws and regulations. It was stated that, particularly in the case of works contracts, the rule enabled contractors and suppliers, in preparing their tenders, to assess more accurately the costs of performing the contract and avoided the necessity to include in their tender prices an increment to reflect the risk of higher costs due to changes in the laws or regulations.

114. The prevailing view, however, was that the article should be deleted. In support of that view, it was said that flexibility should be provided so as to enable the question of which party was to bear the additional costs arising from changes in laws and regulations to be settled in accordance with the circumstances of each procurement.

In some cases, for example, the contract might treat those costs as reimbursable costs. It was also agreed that the procurement documents should indicate which party was to bear the costs (see paragraph 88, above). Furthermore, it was agreed that paragraph 6 of the commentary to article 18 be retained. A proposal was made that the paragraph mention the possibility that, when enacting the model law, the implementing State might include an express provision as to which party was to bear the costs in question.

### Article 22

#### *Clarifications and modifications of procurement documents*

115. With respect to paragraph (2), it was generally agreed that the procuring entity should be able to modify the procurement documents only if it reserved the right to do so in those documents. It was also agreed that, where the procuring entity modified the procurement documents, it should be required to extend the deadline for submission of tenders if necessary in order to allow contractors and suppliers to seek and obtain clarifications of the modification or to amend or withdraw their tenders.

116. A view was expressed that the model procurement law should enable contractors and suppliers to recover any additional costs incurred by them as a result of a modification of the procurement documents.

117. It was suggested that the words "or in any other form that preserves a record of the request, response or addendum" which appeared in paragraph (3), and similar formulations that appeared elsewhere in the text, be examined to ensure that they covered such means of communication as telex and telefax. In addition, a view was expressed that requests for clarification and responses to those requests, and other communications provided for in the text, should be able to be made by telephone, provided that a written confirmation of the communication was dispatched immediately afterwards.

118. In connection with paragraph (4), it was suggested that greater prominence be given to the usefulness of pre-tender meetings of contractors and suppliers in appropriate cases (e.g., in the case of procurement of complex or high-value goods or construction). A query was raised as to the necessity for the requirement that the minutes of the meeting not identify the sources of requests for clarification of the procurement documents. It was pointed out that, except in the case of requests submitted in writing, participants at the meeting would know the sources of requests made at the meeting.

### Article 23

#### *Language of tenders*

119. It was generally agreed that article 23 should be simplified by providing that tenders may be formulated in any language in which the procurement documents were issued.

### Article 24

#### *Submission of tenders*

120. With respect to paragraph (1), it was generally agreed that the amount of time allowed for the submission of tenders should take into account not only the time needed by contractors and suppliers, but also the reasonable needs of the procuring entity. A question was raised as to what consequences would accrue to the procuring entity if the time allowed was too short.

121. It was agreed that the procuring entity should be obligated, and not merely permitted, to extend the deadline for submission of tenders under the circumstances referred to in paragraph (2)(a)(i), i.e., to enable contractors and suppliers to react to a clarification or modification of the procurement documents.

122. A proposal was made that paragraph (2)(a)(ii) be deleted. According to that provision, the procuring entity could extend the deadline if, due to unforeseen circumstances, it was not possible for contractors or suppliers to submit their tenders by the deadline. It was said that the phrase "due to unforeseen circumstances" was vague and could give rise to disputes. The prevailing view was that provision for extension of the deadline in the case envisaged was important; however, in contrast to its decision with respect to paragraph (2)(a)(i), the Working Group agreed that an extension under paragraph (2)(a)(ii) should be at the option of the procuring entity. The Working Group further agreed that the situation referred to in paragraph (2)(a)(ii) should not be the only case in which the procuring entity had the option to extend the deadline, and that the provision should be drafted to encompass the possibility of extending the deadline in other situations.

123. The Working Group agreed to the deletion of the sentence within square brackets in paragraph (3), which provided that a tender submitted after the deadline for submission of tenders could be considered if the contractor or supplier was not able to submit its tender by the deadline due to reasons beyond its control. First, the formulation was found to be too general; it thus could give rise to disputes and was susceptible to abuse. Secondly, the consideration of a late tender, even in good faith, could give rise to at least an appearance of impropriety, which could impugn the integrity of the procurement process. In opposition to the deletion of that provision, it was said that the procuring entity should have the flexibility to consider a late tender in appropriate circumstances. (See, also, paragraph 150, below.)

### Article 25

#### *Period of effectiveness of tenders; modification and withdrawal of tenders*

124. With respect to paragraph (2)(a), it was agreed that requests by the procuring entity for extensions of the period of effectiveness of tenders be discouraged by providing that extensions may be requested only in exceptional circumstances. In that connection, mention was made of an undesirable practice by which procuring entities sometimes pressured contractors and suppliers to grant

an extension by threatening to claim under the tender securities supplied by the contractors and suppliers. It was further agreed that the provision clarify that, if a contractor or supplier did not agree to extend the period of effectiveness of its tender, it could participate no further in the tendering proceedings.

125. It was agreed that paragraph (2)(b) be modified so as to provide that the procuring entity "shall" require contractors and suppliers that extend the period of effectiveness of their tenders to extend also the period of effectiveness of their tender securities or to provide new securities, in order to provide protection for the procuring entity in respect of the extended period of effectiveness of the tender.

126. In connection with paragraph (3), various views were expressed as to whether or not a contractor or supplier should be able to modify or withdraw its tender prior to the deadline for the submission of tenders. One view was that it should not be possible to do so, because to permit modification or withdrawal of tenders after they had been submitted could lead to abuse and improprieties. Another view was that whether a tender could be modified or withdrawn prior to the deadline for submission of tenders should depend on the circumstances of each procurement; and that it should be stated in the procurement documents whether a tender could be modified or withdrawn. Yet another view was that withdrawal of a tender was not likely to lead to abuse or improprieties and should be permitted, but the ability to modify a tender presented dangers, and should be precluded. A further view was that modification and withdrawal of tenders could not lead to abuse or improprieties, particularly if tenders remained sealed, and that paragraph (3) should be retained in its current form. In connection with that view, it was stated that the ability to modify or withdraw tenders was often recognized in practice. In addition, it was pointed out that modification of a tender would be beneficial to the procuring entity if it resulted in a lower tender price.

127. After the discussion, the Working Group considered that it was not yet able to take a decision on the question. It requested the Secretariat to investigate the practice with respect to the modification and withdrawal of tenders, and the related question of forfeiture of a tender security if a tender were to be modified or withdrawn, and to communicate the results of that investigation to the Working Group at its next session.

#### *Article 26*

##### *Tender securities*

128. It was emphasized that the procurement documents should specify the nature, amount and terms and conditions of the tender security to be provided by contractors and suppliers and the types of institutions from which securities would be acceptable, as provided in article 18(1). It was also agreed that it may in some cases be desirable for the procuring entity to provide options with respect to the nature of the security and the issuing institution, and that the possibility of specifying those options

should be made clear in articles 2(f) and 18(1). It was also said to be desirable for the commentary to provide guidance to the procuring entity with respect to the various aspects of the tender security to be required.

129. The principle underlying paragraph (1)(b), namely, to avoid requirements with respect to tender securities that would create obstacles to participation in tendering proceedings by foreign contractors and suppliers, was regarded as important. It was agreed that the procuring entity should not be able to stipulate that the tender security must be issued by a local institution. It was also agreed, however, that the provision be reformulated so as to provide that the issuer of the tender security, whether a foreign or a local institution, must be acceptable to the procuring entity. In particular, the procuring entity should be able to evaluate the credit-worthiness of the institution issuing the security. In that connection, it was suggested that a mechanism be provided whereby a contractor or supplier proposing to provide a tender security issued by a foreign institution could consult with the procuring entity to obtain its approval of the tender security prior to submission of the tender. According to another proposal, provision should be made for the procuring entity to specify in the procurement documents which foreign institutions would be regarded as acceptable.

130. It was observed that procuring entities sometimes required tender securities issued by a foreign institution to be confirmed by a local institution. A view was expressed that the practice should be discouraged. One reason for that view was that foreign institutions were sometimes unable to arrange for confirmation of a security before the deadline for submission of tenders.

131. It was noted that it was unclear whether the words "the type or a type", used in paragraph (1)(b), referred to the type of institution or to the type of tender security.

132. In support of the policies behind paragraph (2), it was said to be important for the model law to contain clear rules concerning the time after which a claim under the tender security could no longer be made and the time when the security must be returned to the contractor or supplier that provided it. Such rules were said to be necessary because procuring entities sometimes improperly claimed under tender securities and refused to return them when they should be returned. However, it was observed that the Commission's Working Group on International Contract Practices was preparing a uniform law on independent guarantees and stand-by letters of credit, and a view was expressed that consideration of paragraph (2) should be deferred to await the outcome of the work. That would enable the Working Group on the New International Economic Order to take into account the results of the work on independent guarantees and stand-by letters of credit, and would avoid any conflicts with or prejudgement of those results. The prevailing view, however, was that it was useful to deal with paragraph (2) at the current stage of the preparation of the model procurement law, since it concerned issues raised by the use not only of guarantees, but also of other types of securities, in the particular context of tendering proceedings. It was doubted whether there would be any overlap with the



work of the Working Group on International Contract Practices. It was also noted that, to the extent that it was relevant to tender securities, the progress of that work could be taken into account before the model procurement law was finalized.

133. Paragraph (2) was found to be broadly acceptable. However, a proposal was made that paragraph (2)(a) be modified so as to refer to the time when the tendering proceedings terminated, instead of the time when the tender security expired. In addition, it was agreed that the listing in paragraph (2), of the circumstances in which a claim under the tender security could no longer be made and the security must be returned, be expanded by referring also to the withdrawal of the tender and the tender security, if permitted (see paragraphs 126 and 127, above), prior to the deadline for submission of tenders.

134. A suggestion was made that article 26 deal with the case where a tender security was required only after the opening of tenders and only from certain contractors and suppliers. The prevailing view, however, was that a tender security should be provided at the time of submission of the tender in order to provide sufficient protection to the procuring entity.

135. A proposal was made that a provision be included, either in article 26 or in article 2(f), indicating the obligations that were to be secured by the tender security. Such a provision might be based upon the discussion of that issue in paragraphs 1 and 7 of the commentary.

136. A proposal was made that the reference in paragraph 1 of the commentary to securities which could be claimed without having to prove a default by the contractor or supplier be deleted, since that type of security should not be encouraged.

#### *Article 27*

##### *Opening of tenders*

137. In connection with paragraph (1), a view was expressed that there should be no time gap between the deadline for the submission of tenders and the opening of tenders. It was said that opening tenders at the deadline for submission of tenders or immediately thereafter would promote transparency and minimize the opportunity for interference with or manipulation of tenders. It was generally agreed that the drafting of the paragraph should be improved so as to clarify that the words "or an extension thereof" referred to the deadline for the submission of tenders, rather than to the time of opening tenders. One suggestion in that regard was to delete the words "or an extension thereof", as they were unnecessary.

138. With respect to paragraph (2), it was generally agreed that the opening of tenders should be public, i.e., in the presence of contractors and suppliers or their representatives. It was noted, however, that in certain countries tenders were not opened publicly, in order to preserve confidentiality in the tendering proceedings. In response, it was stated that confidentiality could be adequately preserved even when tenders were opened in public by

requiring tenders to be sealed and by announcing at the opening only the names and addresses of the contractors and suppliers and their tender prices.

139. It was recognized that certain exceptions to the public opening of tenders might be appropriate. Possible exceptions mentioned were cases where national security or national defence were involved, although it was observed that tendering proceedings might not be appropriate in such cases. In that connection, a proposal was made that those cases be excluded entirely from the scope of the model law. If such exclusions were made optional, the procuring entity would be free to apply the rules and procedures contained in the model law in cases of national security and of national defence when it wished to do so. The Secretariat was requested to prepare a provision to that effect for the next draft of the model law.

140. Another possible exception to the public opening of tenders was said to be cases where tenders were submitted electronically or by telephone. In opposition, however, it was noted that tenders should be required to be submitted in writing and in sealed envelopes. Yet another possible exception was the case of low-value contracts, where the formalities of public opening of tenders would be counter-productive to the objectives of economy and efficiency.

141. It was generally agreed that exceptions to the public opening of tenders should be permitted, if at all, in only a limited number of cases, and that the criteria for invoking an exception should be strictly and narrowly formulated.

142. A suggestion was made that paragraph (3) require the names and addresses of contractors and suppliers and their tender prices to be recorded immediately in the minutes of the tendering proceedings provided for in article 33, in order to prevent improprieties. An additional proposal was that the paragraph require such information to be communicated to any contractor or supplier that had submitted a tender but that was not present or represented at the opening of tenders.

143. With respect to paragraph 2 of the commentary, a question was raised as to the desirability of having tenders opened by a committee.

#### *Article 28*

##### *Examination, evaluation and comparison of tenders*

##### *Paragraph (1)*

144. The Working Group decided to retain the rule set forth in paragraph (1)(a) permitting a procuring entity to seek clarifications from contractors and suppliers of their tenders. A concern was expressed, however, that, despite the prohibition against changes in the tender price or other matters of substance in the tender, the ability to clarify tenders might provide opportunities for abuse.

145. The understanding of the Working Group was that paragraph 1(b) referred to errors in computation that were apparent on the face of the tender and did not encompass,

for example, abnormally low tender prices that were suspected to result from misunderstandings or errors that were not apparent from the face of the tender.

146. Various views were expressed as to how the errors covered by that provision should be treated. One view was that the procuring entity should be able to correct those errors on its own initiative, without consulting with the contractor or supplier. In opposition, that approach was said to present dangers of abuse. It was said to be preferable to bring the errors to the attention of the contractor or supplier and give it the opportunity either to confirm its figures or to withdraw its tender. Under a variation of that approach, the contractor or supplier would be given the option either to agree to a correction or to withdraw its tender. According to another proposal, a distinction should be made between simple errors, which the procuring entity should be able to correct on its own initiative, and significant errors, which should be brought to the attention of the contractor or supplier. The contractor or supplier would be asked either to confirm its figures or to agree to a correction or, alternatively, would have the option either to agree to a correction or to withdraw its tender. In opposition to that approach, it was said that the concept of a "significant" error was vague and would give rise to uncertainties and disputes. A further view was that the provision should be deleted altogether, and that the question of how computational mistakes in tenders were to be treated should be left to be resolved by other rules of national law. In opposition to that view, it was pointed out that the occurrence of such errors in practice was not infrequent and that the absence of a provision would produce uncertainty and a lack of uniformity in the treatment of the issue. After discussion, the Working Group agreed that paragraph (1)(b) be retained in its current form for the time being and that it be reconsidered at the next session.

#### *Paragraph (2)*

147. A view was expressed that paragraph (2) should be deleted, on the ground that the mechanism of rejection of tenders was not necessary since the procuring entity simply would not accept a tender when a circumstance referred to in the paragraph existed. The prevailing view, however, was that the paragraph should be retained, since the mechanism of rejection was a fundamental feature of tendering proceedings.

148. A proposal was made that paragraph (2) be modified so as to make rejection of tenders on the stated grounds optional, rather than mandatory. The Working Group did not accept the proposal. It was said to be of the essence of formal tendering that a tender must be rejected if it was non-responsive or if the contractor or supplier was unqualified.

149. It was noted that whether or not paragraph (2)(b) should be retained in its current form depended on the eventual decision of the Working Group with respect to paragraph (1)(b).

150. A proposal was made that a provision be added to paragraph (2) to the effect that a tender received after the

deadline for the submission of tenders must be rejected. In opposition to the proposal, it was observed that article 24(3), in which that issue was currently dealt with, was a more appropriate context for the treatment of the issue. In that connection, it was noted that tenders received after the deadline for the submission of tenders must be returned unopened to the contractor or supplier; they therefore were not to be regarded as having been submitted and the question of rejection of those tenders did not arise. The Working Group agreed that the proposed addition to paragraph (2) be included for the time being, and that the Working Group would consider at a later stage whether the issue should be dealt with in article 24(3) or in article 28.

#### *Paragraph (3)*

151. A proposal was made that paragraph (3) be deleted. In support of the proposal, it was stated that the question of attempts improperly to influence the procuring entity was dealt with by other areas of national law, such as criminal law and laws relating to unfair competition, and was beyond the scope of the model law on procurement. It was also stated that, as currently formulated, the provision gave rise to problems and uncertainties. For example, it was said to be difficult for the procuring entity to substantiate the motives and intentions of the contractor or supplier, and the provision was said to be too broad and therefore susceptible to arbitrary or improper application by the procuring entity. Moreover, it was said to be unfair for a contractor or supplier to be disqualified merely on the basis of an accusation by the procuring entity. Another proposal was that a case of improper influence by a contractor or supplier be dealt with in the section of the model law dealing with disputes and redress.

152. The prevailing view was that the model law should provide a means by which the procuring entity could reject a tender in cases of improper influence by a contractor or supplier. According to that view, therefore, paragraph (3) should be retained; but it should be reformulated in a manner that would eliminate the problems and uncertainties that had been identified in its current formulation. To that end, a suggestion was made that the paragraph specify concrete grounds on which the procuring entity could reject a tender, e.g., an offer of a bribe by the contractor or supplier. The requirement, currently contained in the paragraph, that rejection of a tender for one of the stated grounds must be subject to approval by a higher authority should be retained as a safeguard against improper application of the paragraph. In addition, a record of the rejection and the grounds therefor should be prepared and kept, for the protection both of the contractor or supplier and of the procuring entity.

153. It was generally agreed that the model law should provide a means for review of a rejection of a tender under paragraph (3) and appropriate remedies (e.g., damages) for a contractor or supplier in the event that rejection of its tender was not justified. A suggestion was made that the model law provide for arbitration proceedings to perform that role.

154. The Working Group agreed that the proceedings for review should not delay the tendering proceedings. In that

connection, a proposal was made that the contractor or supplier be able to seek review immediately upon rejection of its tender, without, however, interrupting the tendering proceedings. According to another proposal, a contractor or supplier should be able to seek review only after the tendering proceedings had been completed.

155. The Working Group requested the Secretariat to reformulate paragraph (3) for the next draft of the model law, taking account of the discussion at the current session.

#### Paragraph (4)

156. General agreement was expressed with the principle underlying paragraph (4), namely, that a tender must be rejected if it did not conform in all respects to the requirements set forth in the procurement documents, except where deviations from those requirements were minor. However, the paragraph in its current form was found to give excessive prominence and scope to the concept of minor deviations. It was agreed that the paragraph be reformulated so as to set forth only a general rule to the effect that a procuring entity might regard a tender as responsive if the tender contained only minor deviations from the requirements set forth in the procurement documents, and that "responsive tender" be defined in the article containing definitions (currently article 2). Under that approach, the procuring entity would have the flexibility to determine whether or not a deviation was minor in the context of the particular procurement proceedings. It was stated that an adequate mechanism of review should be provided for disputes as to whether particular deviations were minor. The Working Group agreed that paragraph 4(b) be deleted, as it was unnecessary in view of the approach that had been agreed.

157. It was stated that in some countries strict conformity of a tender with the specifications and other requirements set forth in the procurement documents was not an essential feature of tendering proceedings.

#### Paragraphs (5) and (6)

158. A question was raised as to whether alternative tenders should play any role in competitive tendering. In that connection, it was said that consideration of alternative tenders conflicted with the essential principle underlying competitive tendering that all tenders must conform to the same specifications and other requirements set forth in the procurement documents. Moreover, the consideration of alternative tenders was said to arise in many cases from an inability of the procuring entity to specify with sufficient precision the technical or other characteristics of the goods or construction that it wished to procure. Accordingly, the view was expressed that alternative tenders should be regarded as analogous to the proposals that were the subject of article 31, and should be dealt with in the context of that article. According to another view, however, alternative tenders were a reality in tendering proceedings. They played a beneficial role in those proceedings by enabling the procuring entity to take advantage of solutions to its procurement needs that might be superior to the solution set forth in the procurement documents.

Therefore, the model law should contain appropriate provisions dealing specifically with alternative tenders.

159. Paragraph (5) dealt with alternative tenders that had been expressly solicited in the procurement documents. In favour of retaining the paragraph, it was stated that without such a provision it might be uncertain in some legal systems whether or not alternative tenders could be solicited. The prevailing view was that, since those tenders were not *per se* unresponsive and should be treated as any other tender, the paragraph was not needed and should be deleted.

160. Paragraph (6) dealt with alternative tenders that had not been solicited by the procuring entity. The current text of the model law contained two alternative versions of the paragraph, designated as alternative 1 and alternative 2. Under alternative 1, an unsolicited alternative tender could be considered only if it was submitted by the contractor or supplier that had submitted the lowest or most economically advantageous responsive tender. That alternative was found by the Working Group to be unacceptable, because even though a contractor or supplier had submitted the most advantageous responsive tender its alternative tender might not be the most advantageous of the alternative tenders that had been submitted.

161. Alternative 2 of paragraph (6) enabled the procuring entity to consider an alternative tender even if the contractor or supplier had not also submitted a responsive tender; however, it required that an opportunity be given to the other contractors and suppliers that had submitted responsive tenders to submit altered or new tenders based on the alternative tender. That approach was found to be generally preferable to the approach in alternative 1 of paragraph (6).

162. It was recognized, however, that alternative 2 of paragraph (6) contained certain disadvantageous features. For example, the ability of other contractors and suppliers to submit altered or new tenders based upon an alternative tender was said to be cumbersome and time-consuming, particularly where several alternative tenders had been submitted. In addition, it was said that to reveal an alternative tender to other contractors and suppliers could violate intellectual property rights or rights of confidentiality of the contractor or supplier that had submitted the alternative tender. In the light of those disadvantages, a suggestion was made that paragraph (6) be deleted altogether. That suggestion was further supported by an opinion that retention of paragraph (6) would be inconsistent with the previous decision to delete paragraph (5).

163. Various suggestions were made as to how alternative 2 should be treated, if it were to be retained in some form. According to one suggestion, alternative 2 should be altered so as to provide that the procuring entity might consider any alternative tender submitted by a contractor or supplier that had also submitted a responsive tender. Another suggestion was that alternative 2 be merged with paragraph (5) by providing, in essence, that the procuring entity might consider any alternative tender, whether

solicited or unsolicited, together with the responsive tenders.

164. In the light of the various views that had been expressed and, in particular, in the light of the view that alternative tenders should be dealt with in the context of article 31 (see paragraph 158, above), the Working Group deferred its decision concerning paragraph (6) until after its consideration of article 31. After it had considered article 31, the Working Group agreed that alternative tenders be encompassed within the situations covered by article 31, and that paragraph (6) of article 28 be deleted. It was also agreed that, if the procuring entity wished to be able to consider alternative tenders, the procurement documents should so specify and should indicate how those tenders would be considered.

#### Paragraph (7)

165. It was agreed that all criteria that were to be used in evaluating and comparing tenders should be set forth in the procurement documents. A number of delegations were of the view that the weightings to be given to those criteria should also be set forth.

166. It was observed that the term "most advantageous tender" was used in subparagraph (a) and in various other places throughout the text of the model law. The view was expressed that, although the term was defined in subparagraph (c), it could be misinterpreted in such a way as to imply that the procuring entity had considerably more discretion in evaluating tenders than was intended. That danger was particularly acute in connection with provisions containing the term that were located in the text of the model law some distance away from the definition. It was therefore agreed that the term be replaced with another term that was less susceptible to misinterpretation.

167. The Working Group doubted the utility of subparagraph (b) in the context of the model law. A suggestion was made that the subparagraph be relocated to the article setting forth the underlying policies or objectives of the model law (currently article 3).

168. The Working Group decided to delete the last clause of subparagraph (c)(ii) ("in so far as such criteria are not the subjects of required characteristics of the goods or construction or required contractual terms or conditions set forth in the procurement documents"), which was found to be confusing and of doubtful utility.

169. With respect to subparagraph (d), it was generally agreed that the procuring entity should be able to take into account socio-economic criteria in evaluating tenders. Although a view was expressed that socio-economic goals should not be achieved by discriminating against foreign contractors and suppliers, it was generally agreed that favourable treatment for local contractors and suppliers was often necessary, in particular in countries that sought to raise their levels of economic and technological development. It was noted that such treatment was provided for in the GATT Agreement on Government Procurement, with which the model law should be consistent. It was

also agreed, however, that the ability of the procuring entity to take socio-economic criteria into account should not be completely unfettered. Rather, some standards should be set forth in the model law as to the nature of the criteria that could be taken into account. Moreover, the criteria that were to be used in evaluating tenders should be set forth in the procurement documents.

170. According to one view, only objective and quantifiable criteria should be taken into account. In that connection, it was suggested that subparagraphs (b) through (d) be simplified by providing merely that tenders should be evaluated on the basis of objective and quantifiable criteria set forth in the procurement documents.

171. According to another view, however, the procuring entity should not be restricted to using only objective and quantifiable socio-economic criteria. It was noted that many socio-economic factors were not susceptible to mathematical or other precise quantification. For the model law to be acceptable to States of all levels of economic and technological development, a procuring entity must be permitted to take those criteria into account. According to that view, subparagraph (d) should be retained; however, the criteria currently contained in the paragraph should be set forth in somewhat more concrete terms.

172. The Working Group regarded the foregoing exchange of views as only a preliminary discussion of the issues that had been raised. The Secretariat was requested to prepare for the next draft of the model law a reformulation of subparagraph (d), taking into account the views that had been expressed. In connection with that reformulation, the opinion was expressed that the phrase "to the extent possible", used in the current version of the paragraph, might offer a means of bridging the gap between the view that only objective and quantifiable criteria could be taken into account and the view that it should be possible to consider criteria that were not objective or quantifiable.

173. With respect to subparagraph (e), it was generally agreed that the model law and the procurement documents should make it clear whether the margin of preference was to be applied in addition to or instead of applicable customs duties. The decision of the Working Group with respect to paragraph 23 of the commentary to article 28 is reflected in paragraph 193, below.

#### Paragraph (8)

174. The Working Group found paragraph 8 to be satisfactory, subject to some drafting suggestions. In particular, it was suggested that a cross-reference be added to article 18(q) in order to make it clear that tenders were to be converted to a single currency in the manner described in that provision. It was also suggested that it be made clear that all tender prices were to be converted to the same currency.

#### Paragraph (9)

175. Paragraph (9) was found to be satisfactory.

*Paragraph (10)*

176. The Working Group agreed that paragraph 10 be deleted on the ground that the question of approval of acts and decisions taken by the procuring entity was an internal matter of the Government or administration that could be dealt with in the implementing regulations adopted by the enacting State. A suggestion was made that the need for approval be restricted to cases where the value of the goods or construction to be procured exceeded a specified threshold amount. An advantage of setting approval requirements in the implementing regulations was said to be greater flexibility in the event the enacting State wished to modify the requirements (e.g., a change in the threshold amount above which approval was required). It was pointed out that in some States acts and decisions of the procuring entity were not subject to approval. The Working Group agreed that when acts or decisions taken by the procuring entity were subject to approval the procurement documents should so indicate.

*Article 29**Rejection of all tenders*

177. It was agreed that paragraph (1) be redrafted so as to improve its clarity. One proposal for doing so was that the necessity for cross-references be removed by stating that the procuring entity might reject all tenders for any purpose other than to engage in competitive negotiations or for any fraudulent purpose. A proposal was made that article 29 specify that the procuring entity could reject all tenders only if it reserved the right to do so in the procurement documents.

178. The Working Group considered whether the procuring entity should be able to reject all tenders until the procurement contract entered into force, as was currently provided in paragraph (1), or until a tender had been accepted. In that connection, it was observed that, under its current formulation, article 32 provided two possibilities with respect to the acceptance of a tender and the entry into force of the procurement contract. Under article 32(2), the contract would enter into force at the same time that the tender was accepted. Under article 32(3), the contract would not enter into force until a written contract was signed, which would be after the tender had been accepted. The question as to the latest time when all tenders could be rejected therefore had practical relevance only in the case envisaged by article 32(3).

179. The prevailing view was that the procuring entity should be able to reject all tenders only until a tender had been accepted. In support of that view, it was stated that, even if acceptance of a tender did not result in the entry into force of a procurement contract, under article 32 it would give rise to certain mutual rights and obligations on the part of the procuring entity and the contractor or supplier whose tender had been accepted. Allowing the procuring entity to reject a tender that had been accepted would interfere with those rights and obligations and would disrupt the balance in them. In addition, it was said

to be illogical to reject a tender that had already been accepted.

180. In support of enabling the procuring entity to reject all tenders until the entry into force of the procurement contract, it was stated that events could occur making it necessary for the procuring entity to be able to reject all tenders and terminate the proceedings during the time gap between acceptance of a tender and entry into force of the contract.

181. It was agreed that paragraph (2) be modified so as to provide that the procuring entity must, upon request, give the reasons for rejection of all tenders, but that it did not have to justify those reasons.

*Article 30**Negotiations with contractors and suppliers*

182. The Working Group agreed that paragraph (1)(a) be deleted in consequence of its decision, taken in connection with article 18(j), that establishing maximum or minimum tender prices or a range of prices within which tenders must fall was an undesirable practice that should not be referred to in the model law (see paragraph 89, above). It was observed that, where all tenders substantially exceeded an estimated tender price, a problem in the specifications might have been the cause (e.g., the specifications might have called for excessively costly materials or construction methods). It was agreed that, in such a case, the procuring entity could exercise its right to reject all tenders and should be able either to modify the specifications and re-institute tendering proceedings, or to engage in negotiations with the contractor or supplier that had submitted the lowest or most economically advantageous tender. However, those possibilities could be provided for elsewhere in the model procurement law (e.g., article 7).

183. The Working Group also agreed that paragraph (1)(b) be deleted, on the ground that the case envisaged (that no one tender was obviously the lowest or the most economically advantageous tender) was unlikely to occur in practice. In addition, the provision was said to be subject to abuse. It was also agreed that paragraph (2) be deleted, in the light of the decision of the Working Group to delete similar wording from article 28(7)(c)(ii) (see paragraph 168, above).

184. After having decided to delete paragraphs (1) and (2), the Working Group considered whether to retain the *chapeau* of article 30. General agreement was expressed with the principle set forth in the *chapeau* that, in the context of formal tendering proceedings, no negotiations should take place between the procuring entity and contractors or suppliers. According to one view, because of the importance of that principle, it would be useful to retain it in a separate article of the model law, with some drafting changes. The prevailing view, however, was that the principle should be located elsewhere in the model law. Accordingly, article 30 was deleted in its entirety.

*Article 31**Special tendering procedures for solicitation of proposals*

185. The Working Group found the procedures provided for in article 31 to be generally acceptable, subject to various improvements. It was observed that the procedures were intended to be used where tendering proceedings could not be conducted on the basis of detailed specifications and other requirements (e.g., where the procuring entity sought to procure technologically advanced equipment for which precise specifications could not be formulated) and where it was not desirable for the procurement to be engaged in by competitive negotiations or by single-source procurement. It was noted that there existed in national legal systems numerous variations on and alternatives to the model presented in article 31. It was recognized, however, that a uniform law on procurement could not attempt to encompass all of those variations and alternatives; rather it should provide clearly differentiated sets of procedures that were suitable for procurement in various types of situations. It was suggested that it would be useful for the commentary to mention that other variations and alternatives to the procedures provided for in article 31 were used in various countries.

186. It was observed that the procedures provided in article 31 were broadly similar to a method of procurement often referred to in international practice as "two-stage tendering". They differed, however, from another method of procurement, often referred to as "requests for proposals". In the latter method, the procuring entity set forth the broad parameters of its procurement needs, requested proposals from a relatively small number of contractors and suppliers and negotiated with contractors and suppliers submitting the proposals to arrive at the most suitable proposal. Price was in many cases included within the scope of the negotiations. It was agreed that the title of the article be changed to "two-stage tendering proceedings" in order to reflect the subject-matter of the article and to avoid confusion as to the essential nature of the procedures provided.

187. A number of delegations were of the view that, in addition to procedures provided in article 31, the model law should provide for requests for proposals or, at least, should not prohibit that method of procurement. According to a contrary view, however, that method was used for the procurement of services such as consultant services but was not used for the procurement of goods or construction; accordingly, the method should not be provided for in the model law, which did not at the current stage apply to services.

188. In connection with paragraph (1), it was agreed that the situations in which the procedures provided by the article could be used should be expanded, so as not to be restricted to cases where the procuring entity sought proposals with respect to the technical characteristics of the goods or construction. For example, the procedures should be able to be used when the procuring entity sought proposals with respect to contractual terms and conditions (e.g., payment conditions).

189. The Working Group found that, despite paragraph (2) and despite the placement of article 31 within the section of the model law dealing with tendering proceedings, it was not sufficiently clear that the various aspects of the procedures (e.g., the evaluation criteria; the opening, examination, evaluation and comparison of the tenders containing the proposals) were to be governed by the rules of the model law relating to tendering proceedings, except in so far as those rules were derogated from in article 31. It was agreed that greater clarity in that respect should be achieved, perhaps by including in article 31 cross-references to key articles relating to tendering proceedings, such as article 28.

190. It was noted that one rule applicable to tendering proceedings, including the procedures provided by article 31, was that the criteria for evaluating the proposals must be set forth in the procurement documents. It was stated, however, that certain criteria might depend on characteristics of the proposals resulting from the discussions provided for in paragraph (4). Thus, it was suggested that the procuring entity be able to change the criteria or add new ones after receiving the proposals.

191. It was agreed that paragraph (4) should make it clear that the reference to "discussions" encompassed negotiations. It was also agreed that the words, "other than a required characteristic of the goods or construction or a required contractual term or condition set forth in the procurement documents", be deleted in view of prior decisions to delete similar wording that appeared elsewhere in the model law (see paragraphs 168 and 183, above).

192. It was agreed that wording be added to paragraph (5) to the effect that the procuring entity could modify the specifications, if necessary. A proposal was made that the reference to a tender security be deleted, since it should not be necessary for contractors and suppliers to submit tender securities with their initial proposals.

193. It was agreed that paragraph 23 of the commentary to article 28 be deleted, since the "two-envelope system" served no useful purpose and was less efficient than the usual method of submitting and opening the technical component and the price component of tenders as a single unit.

*Article 32**Acceptance of tender and entry into force of procurement contract*

194. Pursuant to its previous decision that the requirement of approval of acts and decisions of the procuring entity be dealt with in the implementing regulations and not in the model law (see paragraph 176, above), the Working Group decided to delete the words "subject to approval" from paragraphs (1) and (4).

195. A view was expressed that, in paragraphs (2) and (3), reference should be made to the "receipt" of the notice of acceptance of the tender, rather than to its dispatch. The prevailing view, however, was that the refer-

ence should be to the "dispatch" of the notice. Accordingly, alternative 1 of paragraph (6)(b) was adopted.

196. An opinion was expressed that, as currently drafted, paragraphs (2) and (3)(b) appeared to be inconsistent with each other, in that paragraph (2) provided that the procurement contract entered into force when the notice of acceptance of the tender was given and paragraph (3)(b) provided that the contract entered into force when a written contract document was signed. It was agreed that the apparent inconsistency should be eliminated by clarifying that paragraphs (2) and (3) provided two alternative possibilities with respect to the time when the contract entered into force; namely, paragraph (3)(b) applied only when a written contract document had to be signed, while paragraph (2) applied in all other cases. A proposal was made that paragraph (3)(a) be redrafted so as to clarify that the signature of a written contract document was necessary only when required by the notice of acceptance of the tender. However, a further proposal was made that a requirement be added to paragraph (3)(a) to the effect that a written contract document must be signed when required by other mandatory legal rules of the law applicable to the formation of the contract.

197. After that discussion, the Working Group addressed the specific question of the time when the procurement contract should be regarded as having entered into force. One view was that the approach in paragraph (2) should be followed in all cases, rather than the approach in paragraph (3). In support of that view, it was said that the approach in paragraph (2) was followed in many areas of the world. The approach in paragraph (3) was said to give rise to questions as to the rights and obligations of the parties during the interval between the time when the notice of acceptance of the tender was dispatched and the time when the contract document was signed. In addition, the approach was said to present the danger of disruption of the procurement during the interval, e.g., by a failure of the contractor or supplier to sign the contract document, as well as an opportunity for improper practices by a party during the interval.

198. Another view was that the approach in paragraph (3) should be followed in all cases, and that paragraph (2) should be deleted. Paragraph (3) was said to represent the practice in some countries. It was noted that tenders might be modified one or more times and that, if the contract were to enter into force upon dispatch of the notice of acceptance of the tender, it might be uncertain what the terms of the accepted tender were. Providing that the contract entered into force only upon the signature of a written contract document would eliminate that uncertainty.

199. According to yet another view, the question of when the contract entered into force should be resolved by rules, other than the model law, of the law applicable to the formation of the contract. In support of that approach, it was stated that some legal systems contained mandatory legal rules with respect to the entry into force of contracts, with which the model law should not interfere (e.g., rules requiring certain types of contracts, such as those involving a transfer of technology, to be in writing or to be approved by a particular governmental authority). It was

pointed out, however, that the model law set forth rules and procedures that were designed to meet the particular needs of public procurement, and that a reference to other rules of the law applicable to the formation of the contract might result in the application of inconsistent rules and procedures. In addition, it was observed that the suggested approach would not contribute to uniformity of law.

200. A further view was that both paragraphs (2) and (3) should be retained, subject to certain clarifications and drafting improvements. It was pointed out that some legal systems countenanced both of the approaches reflected in those paragraphs.

201. It was generally agreed that, whichever approach was followed, the procurement documents should clearly indicate the formalities that would be required in order for the procurement contract to enter into force, and that a requirement to that effect should be added to article 18(f).

202. Concerning the case where the procurement contract did not enter into force until a written contract document had been signed, it was generally agreed that paragraph (3)(b) did not adequately elaborate the rights and obligations of the parties during the interval between the time of dispatch of the notice of acceptance of the tender and the time of signature of the contract document. It was generally agreed that those rights and obligations should be mutual and balanced and that paragraph (3)(b) as currently drafted was deficient in that respect. A suggestion was made, for example, that the paragraph specifically obligate the procuring entity and the contractor or supplier whose tender had been accepted to sign the contract document. In response, however, it was stated that the model law already provided mutual and balanced obligations in respect of the interval; namely, a tender could not be withdrawn after the deadline for the submission of tenders and had to remain in force during the time specified in the procurement documents (article 25), and the contractor or supplier whose tender had been accepted was obligated to enter into a procurement contract or forfeit its tender security; the procuring entity, for its part, could not reject all tenders after a tender had been accepted (article 29) and was obligated by virtue of its acceptance of a tender to sign the contract document.

203. According to another view, various additional rights and obligations of a quasi-contractual nature accrued to the parties during the interval as a result of the acceptance of a tender, and paragraph (3)(b) should elaborate those rights and obligations more fully. A contrary view was that the only obligation of the parties was to sign a written contract conforming to the terms and conditions of the tender that had been accepted.

204. A view was expressed that article 32 should deal with the question of the remedies that would be available to one party if the other party violated an obligation incumbent upon it as a result of the acceptance of the tender. A suggestion was made, for example, that the article specify whether the procuring entity would be entitled to damages in addition to claiming under the tender security where the contractor or supplier failed to sign a written contract document. One suggestion was that the question be dealt with in the portion of the model law dealing with redress. Another view, however, was that the

approaches to the question in national legal systems varied widely, and that it would be difficult to deal with it in the model law. According to that view, the question should be left to be resolved by rules of national law other than the model law, but the various approaches under national law might be mentioned in the commentary.

205. With respect to paragraph (4), the view was expressed that, if the contractor or supplier whose tender had been accepted failed to sign the written contract document or to provide a performance security, the procuring entity should be required to accept the next most advantageous tender; the procuring entity should not merely be permitted to do so, as appeared to be the case under paragraph (4) as currently formulated. The suggested approach was said to be consistent with the disciplined nature of formal competitive tendering. The approach was also said to be consistent with article 7(2)(b)(ii), which provided that the procuring entity would not be entitled to engage in competitive negotiations in the event of such a failure by the contractor or supplier if there remained in effect other responsive tenders from qualified contractors and suppliers. According to another view, however, paragraph (4) should be retained in its current form.

206. The Working Group requested the Secretariat to prepare for the next session of the Working Group a new text for article 32, taking into account the discussions at the current session and, in particular, to include a provision elaborating the rights and obligations of the parties during the interval between acceptance of a tender and signature of a written contract document.

### Article 33

#### *Minutes of tendering proceedings*

207. It was generally agreed that the reference to "minutes of tendering proceedings" in the title and text of the current article, in the text of article 31(6), and elsewhere in the model law, be changed to "record of tendering proceedings".

208. It was generally understood by the Working Group that, in cases when all tenders had been rejected by the procuring entity pursuant to article 29, paragraph (1) required only that the record of the tendering proceedings contain a statement to that effect; in accordance with the decision taken by the Working Group during its discussion of article 29, the reasons for the rejection need be given only upon request (see paragraph 181, above).

209. A view was expressed that the expression "made available for inspection", which appeared in paragraph (2), should be clarified. According to one view, the record should be made available only to participants in the tendering proceedings. The prevailing view, however, was that the record should be made available to any person, an approach that would promote honesty and confidence in the procurement process.

210. It was generally agreed that the scope of confidentiality provided in paragraph (2) be expanded by providing that information should not be disclosed if disclosure

would be contrary to law, would impede law enforcement, would not be in the public interest, would prejudice legitimate commercial interests of the parties or would inhibit fair competition. In opposition, it was stated that, under the foregoing formulation, an implementing State could severely restrict the scope of disclosure by adopting laws making various aspects of procurement proceedings confidential.

211. It was generally agreed that information relating to the examination, evaluation and comparison of tenders should not be disclosed. It was stated that tender prices should not be disclosed either, since to disclose tender prices could facilitate the formation of price cartels.

212. A proposal was made that paragraph (2) be reformulated so as to require the record of the tendering proceedings to be made available prior to the entry into force of the procurement contract and not, as currently provided in the paragraph, after the contract had entered into force and the contractor or supplier had supplied a performance security. That change would facilitate the institution of proceedings for redress by an aggrieved contractor or supplier prior to the entry into force of the contract. The ability to institute proceedings prior to the entry into force of the contract would avoid the disruptive effects on the performance of the contract that would result if proceedings were to be instituted after the contract had entered into force.

### Article 34

#### *Competitive negotiation proceedings*

213. A proposal was made that article 34 be deleted. In support of the proposal, it was stated that the provisions of article 7(2), which specified the circumstances in which competitive negotiation proceedings could be used, could be abused by procuring entities seeking improperly to avoid having to engage in tendering proceedings, and could result in higher prices than would be obtained if tendering proceedings were to be engaged in. There was also said to be no need for competitive negotiations in the cases referred to in article 7(2). Those were cases in which, in essence, tendering proceedings had not resulted in a procurement contract. It was said that, in such cases, the procuring entity should modify the specifications or other aspects of the procurement documents, if necessary, and engage in new tendering proceedings. Furthermore, it was said that no safeguards against abusive practices in the competitive negotiations were provided in the model law.

214. The proposal to delete article 34 was not accepted. The Working Group was in general agreement that a procuring entity should be able to engage in competitive negotiation proceedings in certain circumstances and that the model law should provide for that method of procurement. It was also agreed, however, that article 7(2) in its current formulation was too broad, and that the use of competitive negotiation proceedings should be permitted only in very limited circumstances. Suggestions as to those circumstances included cases where tendering proceedings had failed completely and where engaging in



further tendering proceedings would be unlikely to result in a procurement contract; where the goods or construction to be procured were of a low value; where the goods or construction were highly specialized or involved highly specialized technology; or where there was an urgent need for the goods or construction, making the use of tendering proceedings impossible or inadvisable.

215. It was suggested that the text of the model law be reviewed to ensure consistency among the various provisions dealing with the steps to be taken when all tenders had been rejected pursuant to article 28 and article 29.

216. It was agreed that the words in paragraph (1), "but in any case with at least [3] contractors and suppliers unless negotiations with [3] contractors and suppliers are not possible or are not practicable", be deleted.

217. In connection with paragraph (2), the view was expressed that the exception to the requirement that any information relative to the negotiations must be communicated on an equal basis to all contractors and suppliers (namely, that the requirement did not apply to information particular to negotiations with a particular contractor or supplier or to confidential information) was contrary to the principle of equal treatment of all contractors and suppliers. It was also said that the exception could be abused by a procuring entity, and that the circumstances in which the exception was intended to apply were adequately covered by paragraph (3). Accordingly, it was agreed that the exception be deleted from paragraph (2).

218. It was understood that the discussion and decisions of the Working Group with respect to article 33 applied also to paragraph (4) of article 34.

#### *Article 35*

##### *Record of single source procurement*

219. The content of article 35 was found to be generally acceptable. A view was expressed that it might be useful

for the model law or the commentary to explain what was meant by single source procurement. It was suggested that the circumstances in which single source procurement could be used, which were set forth in article 7(3), be examined to ensure that no inconsistency would arise from the changes to be made to article 7(2).

220. It was understood that the discussion and decisions of the Working Group with respect to articles 33 and 34(4) applied also to article 35. It was observed that, under article 35, a procuring entity seemed to be required to prepare a record of all purchases made by it, and it was questioned whether such an approach was desirable.

221. In addition to its discussion with respect to requests for proposals (paragraphs 186 and 187, above), a suggestion was made that the model law deal with a method of procurement referred to as "shopping". Under that method the procuring entity obtained price quotations for goods from suppliers. According to the suggestion, the circumstances in which that method could be used (e.g., for the procurement of standardized finished goods) should be indicated.

### **III. Future work and other business**

222. For the next session of the Working Group, the Secretariat was requested to prepare draft provisions of the model law dealing with redress for actions and decisions contrary to the model law, and to revise the text of the model law to take into account the discussions and decisions at the current session. It was understood that the revision need not attempt to perfect the structure or drafting of the text, since those matters would be dealt with once the substance of the text had been settled. It was also agreed that the commentary would not be revised until after the substance of the text of the model law had been settled, and that no revision of the commentary would be prepared for the next session of the Working Group.

## **B. Procurement: draft model law on procurement: report of the Secretary-General<sup>a</sup> (A/CN.9/WG.V/WP.24) [Original: English]**

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<sup>a</sup>Working paper submitted to the Working Group on the New International Economic Order at its eleventh session.

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## INTRODUCTION

1. The Commission decided at its nineteenth session in 1986 to undertake work in the area of procurement as a matter of priority and entrusted this work to its Working Group on the New International Economic Order.<sup>1</sup> The Working Group commenced its work at its tenth session in October 1988. It devoted that session to deliberations on the basis of a study of procurement prepared by the Secretariat that discussed possible objectives of national procurement policies and that examined national procurement laws and practices and the roles and activities of various international institutions and development funding agencies in connection with procurement (A/CN.9/WG.V/WP.22). After completing its consideration of the study the Working Group requested the Secretariat to prepare a first draft of a model law on procurement and an accompanying commentary taking into account the discussions and decisions at the session (A/CN.9/315, para. 125). It agreed that, while the model law should not be confined to international procurement, it should take into account the particular needs and interests of foreign participants in procurement proceedings (*ibid.*, para. 122). The Commission at its twenty-second session in 1989 expressed appreciation for the work performed by the Working Group so far and requested it to proceed with its work expeditiously (A/44/17, paras. 232 and 235).

2. The present report contains the first draft of a model law on procurement as requested by the Working Group. The commentary is contained in a separate document (A/CN.9/WG.V/WP.25). Provisions concerning the right of aggrieved contractors and suppliers to claim redress for violations of the model law are not contained in the present draft text; that subject will be dealt with in a separate document.

3. The Working Group may wish to discuss the policy issues raised by the draft articles and the commentary and to instruct the Secretariat to redraft the draft articles and commentary on the basis of the discussion.

## DRAFT MODEL PROCUREMENT LAW

### Chapter I. General provisions

#### Article 1. *Application of Law*\*

This Law applies to procurement by procuring entities of goods, through such means as purchase, rental or otherwise, or of construction. The procurement shall be considered to be a procurement of goods or of construction where the goods or construction constitute a substantial part of the procurement.

<sup>1</sup>Report of the United Nations Commission on International Trade Law on the Work of its nineteenth session (*Official Records of the General Assembly, Forty-first Session, Supplement No. 17 (A/41/17)*), para. 243.

\*Article headings are for reference purposes only and are not to be used for purposes of interpretation.

#### Article 2. *Definitions*

For the purposes of this Law:

(a) "procuring entity" means:

(i) any department, agency, organ or other unit, or any subdivision thereof, of the Government or the administration;

(ii) [each State enacting this model law inserts in this subparagraph and, if necessary, in subsequent subparagraphs, other entities or enterprises, or categories thereof, to be included in the definition of "procuring entity"].

(b) "goods" includes raw materials, products, equipment and other tangible objects of every kind and description;

(c) "construction" means such physical work as site preparation, excavation, erection, building, installation of equipment or materials, decoration and finishing, in respect of a new structure or of an existing structure;

(d) "procurement proceedings" means proceedings engaged in or measures taken by a procuring entity with a view towards entering into a procurement contract, including tendering proceedings, competitive negotiation proceedings and single source procurement;

(e) "International tendering proceedings" means the proceedings referred to in article 11, for which chapter II of this Law requires the application of particular procedures with a view towards promoting international participation in the tendering proceedings;

(f) "Tender security" includes such arrangements as bank guarantees, letters of credit, cheques on which a bank is primarily liable and cash deposits, provided by a contractor or supplier to secure obligations in respect of its tender;

(g) "Currency" includes unit of account;

(h) "Competitive negotiation proceedings" means negotiations by the procuring entity with contractors and suppliers with a view towards procurement, such negotiations being subject to rules set forth in article 34 designed to incorporate a competitive element;

(i) "Single source procurement" means procurement from a particular contractor or supplier without engaging in tendering proceedings or competitive negotiation proceedings.

#### Article 3. *Underlying policies*

(1) The underlying policies of this Law are:

(a) to maximize economy and efficiency in procurement;

(b) to foster and encourage participation in procurement proceedings by competent contractors and suppliers, including, where appropriate, international participation;

(c) to promote competition among contractors and suppliers for the supply of the goods or construction to be procured;

(d) to provide for the fair and equitable treatment of all contractors and suppliers in connection with procurement covered by this Law;

(e) to promote the integrity of, and fairness and public confidence, in the procurement process; and

(f) to achieve transparency in the procedures relating to procurement.

(2) This Law is subject to any international agreement, or any agreement with or other obligation towards an international institution or a governmental institution of another State, which has already been or may be entered into by [this State] and which contains provisions concerning the matters governed by this Law.

#### Article 4. *Procurement regulations*

The . . . [each State enacting this model law specifies the organ or authority authorized to promulgate the procurement regulations] is authorized to promulgate procurement regulations to elaborate upon or supplement this Law.

#### Article 5. *Public accessibility of Procurement Law, procurement regulations and other legal texts relating to procurement*

This Law and the procurement regulations, all administrative rulings and directives of general application in connection with procurement covered by this Law, and all amendments of this Law and those regulations and administrative rulings and directives, shall be promptly made accessible to the public.

#### Article 6. *Control and supervision of procurement*

(1) The approval function referred to in articles 7(2), 7(3), 11(2), 12(2), 28(3), 28(10), 29(1), 31(1), [32(1), and] [32(4)] shall be performed by . . . [each State enacting this model law specifies the organ or authority authorized to perform the approval function.]

(2) [Each State enacting this model law specifies in this paragraph and, if necessary, in subsequent paragraphs, any additional functions in connection with the control and supervision of procurement and the organ[s] or authority[ies] to perform those functions.]

#### Article 7. *Methods of procurement and conditions for their use*

(1) Except as otherwise provided by this Law, a procuring entity engaging in procurement shall do so by means of tendering proceedings.

(2) Subject to approval, the procuring entity may engage in procurement by means of competitive negotiation proceedings when:

(a) the price of the procurement contract is less than the amount set forth in the procurement regulations; or

(b) tendering proceedings have been engaged in but:

(i) all tenders were rejected by the procuring entity pursuant to article 28(2) or (3) or article 29; or

(ii) the contractor or supplier whose tender has been accepted fails to sign a procurement contract with the procuring entity when required to do so or fails to supply a required security for the performance of the contract, and no other responsive tender from an eligible and qualified contractor or supplier is in effect.

(3) Subject to approval, the procuring entity may engage in single source procurement when:

(a) the price of the procurement contract is less than the amount set forth in the procurement regulations;

(b) the goods or construction is available only from the particular contractor or supplier or no reasonable alternative or substitute exists;

(c) there is an urgent need for the goods or construction making it impossible or imprudent to use tendering proceedings or competitive negotiation proceedings, as the case may be, because of the amount of time involved in using those proceedings;

(d) for reasons of standardization, or the need for compatibility with existing equipment or technology, goods must be procured from a particular contractor or supplier;

(e) the procuring entity seeks to enter into a contract with the contractor or supplier for the purpose of research, experiment, study or development, except where the contract includes the production of goods in quantities to establish their commercial viability or to recover research and development costs; or

(f) for reasons of national security there is a need for secrecy in respect of the procuring entity's procurement needs.

(4) The procuring entity shall not divide its procurement of the goods or construction into separate contracts for the purpose of invoking paragraph (2)(a) or (3)(a).

(5) A procuring entity that invokes the provisions of paragraph (2) or (3) shall include in the minutes required under article 34(4) or the record required under article 35 a statement of the circumstances on which it relied and, except in respect of paragraph (3)(f), shall specify the relevant facts.

#### Article 8. *Eligibility of contractors and suppliers*

(1)(a) The procuring entity may require contractors and suppliers participating in procurement proceedings to provide such appropriate written statements, documentary evidence or other information as it may deem useful to satisfy itself that the contractors and suppliers:

(i) have legal capacity to enter into the procurement contract;

(ii) are not insolvent, bankrupt or being wound up, their affairs are not being administered by a court or a judicial officer, their business activities have not been suspended, and they are not the subject of legal proceedings for any of the foregoing;

(iii) have fulfilled their obligations to pay taxes and social security contributions in [this State];

(iv) have not been convicted of any criminal offense concerning their professional conduct within a period of [5] years preceding the commencement of the procurement proceedings;

(v) [ . . . ] [each State enacting this model law specifies any additional eligibility requirements.]

(b) The procuring entity may, in addition, investigate by any other appropriate means the eligibility of a

contractor or supplier pursuant to criteria set forth in subparagraph (a).

(2) Any requirement established pursuant to paragraph (1)(a) and the eligibility criteria set forth in that paragraph shall apply equally to all contractors and suppliers. A procuring entity shall impose no eligibility criterion other than those provided for in paragraph (1)(a).

[(3) A contractor or supplier shall not be precluded from participating in procurement proceedings for the reason that it does not conform to one or more eligibility criteria set forth in paragraph (1) if the contractor or supplier undertakes to establish its conformity during the course of the procurement proceedings and if it is reasonable to expect that the contractor or supplier will be able to do so.]

#### Article 9. *Qualifications of contractors and suppliers*

The procuring entity may require contractors and suppliers participating in procurement proceeding to provide such appropriate written statements, documentary evidence or other information as it may deem useful to satisfy itself that the contractors and suppliers possess sufficient qualifications with respect to technical competence, financial resources, equipment and other physical facilities, and sufficient personnel, to perform the procurement contract. Any such requirement, and any criterion established with respect to those qualifications, shall apply equally to all contractors and suppliers. A procuring entity may, in addition, investigate by any other appropriate means the qualifications of a contractor or supplier.

#### Article 10. *Rules concerning written statements and documentary evidence provided by contractors and suppliers*

(1) This article applies to written statements and other documentary evidence provided by contractors and suppliers to demonstrate their eligibility and qualifications in procurement proceedings.

(2) A written statement, and documentary evidence other than that emanating from a governmental, judicial or administrative authority, shall be signed and sworn to or otherwise solemnized by the maker of the written statement or the documentary evidence before a notary or other authority competent under the law of the place where the authority serves to attest to the authenticity of the written statement or documentary evidence and to its signature and solemnization, and the attestation of the notary or other competent authority shall be affixed or joined to the written statement or documentary evidence. The attestation by a foreign notary or other competent authority shall be acceptable if it is legalized in accordance with the law applicable in [this State] relating to the legalization of foreign public documents.

(3)(a) Documentary evidence emanating from a governmental, judicial or administrative authority outside [this State] shall be acceptable if it is legalized in accordance with the law applicable in [this State] relating to the legalization of foreign public documents.

(b) Documentary evidence emanating from a governmental, judicial or administrative authority in [this State]

shall conform to the law applicable in [this State] concerning the signature, solemnization and legalization of such documents.

## Chapter II. Tendering proceedings

### Section I. *International tendering proceedings*

#### Article 11. *International tendering proceedings*

(1) Subject to paragraph (2), a procuring entity that is required under article 7 to engage in tendering proceedings may decide to engage in international tendering proceedings, taking into account the objectives of economy and efficiency in the procurement.

(2) Where the price of the procurement contract exceeds the amount set forth in the procurement regulations, a procuring entity that is required under article 7 to engage in tendering proceedings must engage in international tendering proceedings unless it receives approval not to engage in international tendering proceedings. The procuring entity shall not divide its procurement of the goods or construction into separate contracts for the purpose of avoiding the application of this paragraph.

### Section II. *Solicitation of tenders and applications to prequalify*

#### Article 12. *Solicitation of tenders and applications to prequalify*

(1) A procuring entity shall solicit tenders, and, where applicable, applications to prequalify, from all interested contractors and suppliers by causing a notice of proposed procurement to be published in . . . [each State enacting this model law specifies the official gazette or other official publication in which the notice of proposed procurement is to be published]. In international tendering proceedings, the notice of proposed procurement shall also be published in a newspaper or relevant trade publication or technical journal of wide international circulation. The publication shall be in a language customarily used in international trade.

(2) Where restricted participation in the tendering proceedings is more conducive to economy and efficiency, the procuring entity may, subject to approval, solicit tenders by sending the notice of proposed procurement only to particular contractors and suppliers selected by it. The procuring entity shall select a sufficient number of contractors and suppliers to ensure effective competition, consistent with the efficient conduct of the tendering proceedings.

#### Article 13. *Lists of approved contractors and suppliers*

The procuring entity may use a list of approved contractors and suppliers as its source for the selection of contractors and suppliers from which to solicit tenders pursuant to article 12(2) only if:

(a) requests to be entered on the list are receivable at any time from any interested contractor or supplier and are acted upon within a reasonably short period of time;

(b) entry on the list is subject to no eligibility criterion more stringent than those set forth in article 8(1)(a) and is subject to no qualification criterion more stringent than those established pursuant to article 15;

(c) the existence of the list, the conditions to be satisfied by contractors and suppliers in order to be entered on the list, the methods according to which satisfaction of each of those conditions is to be verified, the period of validity of an entry on the list and the procedures for entry and for renewal of the entry have been generally publicized in a manner designed to bring them to the attention of contractors and suppliers;

(d) the conditions, methods, procedures and other matters referred to in subparagraph (c) do not discriminate against foreign contractors and suppliers with respect to entry on a list used for the solicitation of tenders in international tendering proceedings or with respect to their opportunity to participate in such proceedings; and

(e) the selection by the procuring entity from the list allows all contractors or suppliers on the list equitable opportunities to be selected.

#### Article 14. *Contents of notice of proposed procurement*

(1) The notice of proposed procurement shall contain the following information:

(a) the name and address of the procuring entity;

(b) the nature and quantity of the goods to be supplied or the nature and location of the construction to be effected;

(c) the desired or required time for the supply of the goods or for the completion of the construction;

(d) the eligibility criteria set forth in article 8(1)(a);

(e) the means of obtaining the procurement documents and the place from which they may be obtained;

(f) the price, if any, charged by the procuring entity for the procurement documents and, in the case of international tendering proceedings, the currency and means of payment for those documents;

(g) in the case of international tendering proceedings, the language or languages in which the procurement documents are available;

(h) the place and deadline for the submission of tenders.

(2) If prequalification proceedings are to be engaged in, the notice of proposed procurement shall so state. In such a case, the notice of proposed procurement need not contain the information referred to in paragraph (1)(e) or (g), but shall contain the following additional information:

(a) the means of obtaining the prequalification documents and the place from which they may be obtained;

(b) the price, if any, charged by the procuring entity for the prequalification documents and, in the case of

international tendering proceedings, the currency and terms of payment for those documents;

(c) in the case of international tendering proceedings, the language or languages in which the prequalification documents are available; and

(d) the place and deadline for the submission of applications to prequalify.

### Section III. *Qualifications of contractors and suppliers*

#### Article 15. *Assessment of qualifications of contractors and suppliers*

(1) The procuring entity shall assess the qualifications of contractors and suppliers in accordance with the qualification criteria and procedures set forth in the prequalification documents or in the procurement documents.

(2) The qualification criteria shall be objective to the extent possible and shall be limited to those which are essential to ensure that the contractors or suppliers possess sufficient technical competence, financial resources, equipment and other physical facilities, and sufficient personnel, to perform the procurement contract.

(3) In the case of international tendering proceedings, the procuring entity shall establish no criterion, requirement or procedure with respect to the demonstration or assessment of the qualifications of contractors and suppliers which unduly hinders the ability of foreign contractors and suppliers to show that they are qualified.

#### Article 16. *Prequalification proceedings*

(1) Except where participation in tendering proceedings is restricted pursuant to article 12(2), the procuring entity may engage in prequalification proceedings with a view towards identifying, prior to the submission of tenders, contractors and suppliers that are eligible and qualified to perform the procurement contract.

(2) If the procuring entity engages in prequalification proceedings, it shall provide a set of prequalification documents to each contractor and supplier that requests them in accordance with the procedures specified in the notice of proposed procurement and that pays the price, if any, charged for those documents.

(3) The prequalification documents shall contain all information necessary to enable contractors and suppliers to prepare and submit applications to prequalify, including, but not limited to, the information required to be included in the notice of proposed procurement pursuant to article 14(1), except subparagraph (e) thereof, plus the following information:

(a) instructions for preparing and submitting prequalification applications;

(b) any additional information concerning the goods to be supplied or the construction to be effected that would be useful to contractors or suppliers in preparing their prequalification applications;

(c) a summary of the principal required terms and conditions of the procurement contract to be entered into as a result of the tendering proceedings;

(d) any written statements, documentary evidence or other information that must be submitted by contractors and suppliers to demonstrate their eligibility and qualifications;

(e) the criteria and procedures to be used for assessing the qualifications of contractors and suppliers;

(f) the manner and place for the submission of applications to prequalify and the deadline for the submission, expressed as a specific date and time and allowing sufficient time for contractors and suppliers to prepare and submit their applications, paying particular regard, in the case of international tendering proceedings, to the time needed by foreign contractors and suppliers;

(g) any other requirements established by the procuring entity in conformity with this Law and the procurement regulations relating to the preparation and submission of applications to prequalify and to the prequalification proceedings;

(h) references to this Law, to the procurement regulations and to all other laws and regulations of [this State] directly pertinent to the prequalification proceedings.

(4) The procuring entity shall promptly notify all contractors and suppliers submitting applications to prequalify whether or not they have been prequalified and shall make available to the general public the names of all contractors and suppliers that have been prequalified. All contractors and suppliers that have been prequalified shall be entitled to submit tenders.

(5) The procuring entity shall upon request communicate to contractors and suppliers that have not been prequalified the grounds therefor, but the procuring entity shall not be required to give reasons to substantiate those grounds.

(6) A procuring entity that has engaged in prequalification proceedings is not precluded from re-assessing at a later stage of the tendering proceedings the eligibility and qualifications of contractors and suppliers that have been prequalified.

#### *Section IV. Procurement documents*

##### *Article 17. Provision of procurement documents to contractors and suppliers*

The procuring entity shall provide a set of the procurement documents to contractors and suppliers in accordance with the procedures and requirements specified in the notice of proposed procurement. If prequalification proceedings have been engaged in, the procuring entity shall provide a set of the procurement documents to each contractor and supplier that has been prequalified and that pays the price, if any, charged for those documents.

##### *Article 18. Contents of procurement documents*

The procurement documents shall contain all information necessary to enable contractors and suppliers to pre-

pare and submit responsive tenders, including, but not limited to, the following information:

(a) instructions for preparing tenders;

(b) the eligibility criteria set forth in article 8(1)(a);

(c) if the qualifications of contractors and suppliers are to be assessed or re-assessed after the opening of tenders, the criteria and procedures to be used for the assessment or re-assessment;

(d) any written statements, documentary evidence or other information that must be submitted by contractors and suppliers to demonstrate their eligibility and qualifications;

(e) the nature and required technical and quality characteristics of the goods or construction to be procured, including, but not limited to, technical specifications, plans, drawings and designs as appropriate; the quantity of the goods; the location where the construction is to be effected; and the desired or required time, if any, when the goods are to be delivered or the construction is to be effected;

(f) the required terms and conditions of the procurement contract to be entered into as a result of the tendering proceedings;

(g) whether alternatives to the characteristics of the goods or construction, contractual terms and conditions or other requirements set forth in the procurement documents are solicited;

(h) if contractors and suppliers are permitted to submit tenders for only a portion of the goods or construction to be procured, a specification of the portion or portions for which tenders may be submitted;

(i) the manner and, in international tendering proceedings, the currency or currencies in which the tender price is to be formulated and expressed;

(j) any applicable maximum or minimum tender price, or any applicable range within which tender prices must fall or the formula to be used to establish such range;

(k) in international tendering proceedings, the language or languages in which tenders are to be prepared;

(l) any requirements of the procuring entity with respect to the nature, amount and other principal terms and conditions of any tender security to be provided by contractors and suppliers submitting tenders and of any security for the performance of the procurement contract to be provided by the contractor or supplier that enters into the procurement contract, and with respect to the type or types of institutions or entities from which such securities will be acceptable;

(m) the manner, place and deadline for the submission of tenders;

(n) the means by which, pursuant to article 24, contractors and suppliers may seek clarifications of the procurement documents and the place and time of any meeting of contractors and suppliers convened by the procuring entity;

(o) the period of time during which tenders shall be in effect;

(p) the place, date and time for the opening of tenders, the procedures to be followed for opening, examining, evaluating and comparing tenders and for ascertaining the most advantageous tender, and the criteria to be used for evaluating and comparing tenders and for ascertaining the most advantageous tender, including, but not limited to, such factors as how the criteria will be quantified or otherwise applied, the relative weight or other indication of the degree of importance that each criterion will have, the manner in which the criteria will be combined and in which the tenders will be compared in order to ascertain the most advantageous tender, and any margin of preference that will be applied, its amount and the manner of its application;

(q) in international tendering proceedings, the currency that will be used for the purpose of evaluating and comparing tenders and either the exchange rate that will be used for the conversion of tenders into that currency or a statement that the rate issued by a specified financial institution prevailing on a specified date will be used;

(r) any other requirements established by the procuring entity in conformity with this Law and the procurement regulations relating to the preparation and submission of tenders and to the tendering proceedings;

(s) references to this Law, to the procurement regulations and to all other laws and regulations of [this State] directly pertinent to the tendering proceedings [, and references to tax, social security, safety, environmental protection, health and labour laws and regulations of [this State] pertinent to the performance of the procurement contract];

(t) the name(s) and address(es) of the person or persons authorized to communicate with contractors and suppliers in connection with the tendering proceedings and to whom communications from contractors and suppliers should be addressed.

#### Article 19. *Charge for procurement documents*

The procuring entity may charge contractors and suppliers a sum for procurement documents provided to them. The sum shall reflect only the cost of printing the procurement documents and providing them to contractors and suppliers.

#### Article 20. *Rules concerning formulation of prequalification documents and procurement documents*

(1) Specifications, plans, drawings and designs setting forth the technical or quality characteristics of the goods or construction to be procured, and requirements concerning testing and test methods, packaging, marking or labeling or conformity certification, and symbols and terminology, shall not be included or used in the prequalification documents or in the procurement documents with a view to creating obstacles to participation by contractors or suppliers in tendering proceedings including, in the case of international procurement proceedings, foreign contractors and suppliers, nor shall such specifications, plans, drawings, designs, requirements, symbols or terminology

be included or used which have the effect of creating unnecessary obstacles to such participation.

(2) To the extent possible, specifications, plans, drawings, designs and requirements shall be based on the relevant objective technical and quality characteristics of the goods or construction to be procured. There shall be no requirement of or reference to a particular trade mark, name, patent, design, type, specific origin or producer unless there is no other sufficiently precise or intelligible way of describing the characteristics of the goods or construction to be procured and provided that words such as "or equivalent" are included.

(3)(a) Standardized features, requirements, symbols and terminology relating to the technical and quality characteristics of the goods or construction to be procured shall be used, where available, in formulating the specifications, plans, drawings and designs to be included in the prequalification documents and in the procurement documents.

(b) Standardized trade terms shall be used, where available, in formulating the terms and conditions of the procurement contract to be entered into as a result of the procurement proceedings and in formulating other relevant aspects of the prequalification documents and of the procurement documents.

(c) In the case of international procurement proceedings, internationally standardized features, requirements, symbols, terminology and trade terms shall be used, where available; if they are not available, nationally standardized features, requirements, symbols, terminology and trade terms shall be used, where available.

(4) In the case of international procurement proceedings, the prequalification documents and the procurement documents shall be formulated in . . . [each State enacting this model law specifies its official language or languages] [and in a language customarily used in international trade]. [In the event of a variation or conflict between language versions, the version in the language customarily used in international trade shall prevail.]

[Article 21. *New or amended laws or regulations relating to taxes, customs duties or similar charges, or affecting performance of procurement contract*]

[The procurement contract shall provide for the procuring entity to bear any extra costs incurred by the contractor or supplier that becomes a party to the procurement contract due to new or changes in laws or regulations of [this State] relating to taxes, customs duties or similar charges, or affecting the performance by the contractor or supplier of the procurement contract, that come into force after the date [30] days prior to the deadline for submission of tenders.]

#### Article 22. *Clarifications and modifications of procurement documents*

(1) A contractor or supplier requiring a clarification of the procurement documents shall communicate a request for such clarification to the procuring entity. The procur-



ing entity shall respond promptly to any request for clarification that is received by it prior to the deadline for submission of tenders. Copies of the response by the procuring entity, which shall not identify the source of the request, shall be communicated to all contractors and suppliers to which the procuring entity provides the procurement documents.

(2) At any time prior to the deadline for submission of tenders, the procuring entity may, for any reason, whether at its own initiative or in response to a clarification requested by a contractor or supplier, modify the procurement documents by issuing an addendum thereto. The addendum shall be communicated promptly to all contractors and suppliers to which the procuring entity sends the procurement documents and shall be binding on them.

(3) Any request for clarification and any response thereto by the procuring entity and any addendum to the procurement documents shall be made in writing or in any other form that preserves a record of the request, response or addendum.

(4) If the procuring entity convenes a meeting of contractors and suppliers, it shall prepare minutes of the meeting containing the requests submitted at the meeting for clarification of the procurement documents, without identifying the sources of the requests, and its responses to those requests. The minutes shall be prepared in writing or in any other form that provides a record of the information contained therein and shall be communicated to all contractors and suppliers to which the procuring entity provides the procurement documents.

### Section V. Tenders

#### Article 23. Language of tenders

Tenders shall be formulated and submitted in . . . [each State enacting this model law specifies its official language or languages]. In international tendering proceedings, at the option of the contractor or supplier, tenders may be formulated and submitted in any language in which the procurement documents have been issued.

#### Article 24. Submission of tenders

(1) The procuring entity shall fix a specific date and time as the deadline for the submission of tenders. The deadline shall allow sufficient time for contractors and suppliers to prepare and submit their tenders, paying particular regard, in the case of international tendering proceedings, to the time needed by foreign contractors and suppliers.

(2)(a) The procuring entity may, prior to the deadline for submission of tenders, extend the deadline:

(i) in order to afford contractors and suppliers reasonable time to take into account in their tenders a response by the procuring entity to a request for clarification of the procurement documents or a modification of those documents, or

(ii) if, due to unforeseen circumstances, it is not possible for contractors or suppliers to submit their tenders by the deadline.

(b) Notice of any extension of the deadline shall be given promptly in writing or in any other form that provides a record of the information contained therein to each contractor and supplier to which the procuring entity provides the procurement documents.

(3) A tender received by the procuring entity after the deadline for the submission of tenders shall not be opened or considered and shall be returned to the contractor or supplier that submitted it. [However, a tender submitted after the deadline may be considered if the contractor or supplier was not able to submit its tender by the deadline due to reasons beyond its control.]

(4) Tenders shall be submitted in writing and in sealed envelopes. [However, the procuring entity may give contractors and suppliers the option to submit tenders by any other means that provides a record of the information contained in the tender.] The procuring entity shall provide to the contractor or supplier a receipt showing the date and time when the tender was received.

#### Article 25. Period of effectiveness of tenders; modification and withdrawal of tenders

(1) Tenders shall be in effect during the period of time specified in the procurement documents. The period of time shall commence at the deadline for submission of tenders.

(2)(a) Prior to the expiry of the period of effectiveness of tenders, the procuring entity may request contractors or suppliers to extend the period for an additional specified period of time. A contractor or supplier may refuse the request without forfeiting its tender security. The request and the responses thereto shall be made in writing or by any other means that provides a record of the information contained therein.

(b) The procuring entity may require contractors and suppliers that agree to the extension to extend or to procure an extension of the period of effectiveness of tender securities provided by them or, if it is not possible to do so, to provide new tender securities, to cover the extended period of effectiveness of their tenders.

(3) A contractor or supplier may modify or withdraw its tender prior to the deadline for the submission of tenders by communicating the modification or a notice of withdrawal to the procuring entity in writing or in any other form that provides a record of the information contained therein. The modification or notice of withdrawal is effective if it is received by the procuring entity prior to the deadline for submission of tenders.

### Section VI. Tender securities

#### Article 26. Tender securities

(1) If the procuring entity requires contractors and suppliers submitting tenders to provide a tender security:

(a) the requirement shall apply to all such contractors and suppliers;

[(b) in international tendering proceedings, a contractor or supplier shall not be precluded from providing a tender security issued by a foreign institution or entity of the type or a type, if any, specified in the procurement documents, unless the issuance of the security would otherwise be in violation of the law of [this State]].

(2) The procuring entity shall make no claim to the amount of the tender security, and shall, without delay, return or procure the return of the tender security to the contractor or supplier that supplied it, after the earliest to occur of:

- (a) the expiry of the tender security,
- (b) the entry into force of a procurement contract and the provision of a security for the performance of the contract, if such a security is required, or
- (c) The rejection by the procuring entity of all tenders pursuant to article 28(2) or (3) or article 29.

### **Section VII. Opening, examination, evaluation and comparison of tenders**

#### **Article 27. Opening of tenders**

(1) Tenders shall be opened at the time set forth in the procurement documents as the deadline for the submission of tenders or an extension thereof, at the place and in accordance with the procedures specified in the procurement documents.

(2) All contractors and suppliers that have submitted tenders or their representatives shall be permitted to be present at the opening of tenders.

(3) The name and address of each contractor or supplier whose tender is opened and the tender price shall be announced to those persons present at the opening of tenders.

#### **Article 28. Examination, evaluation and comparison of tenders**

(1)(a) To assist in the examination, evaluation and comparison of tenders, the procuring entity may ask contractors and suppliers for clarifications of their tenders. Any request for clarification and any response to such a request shall be in writing or in any other form that provides a record of the information contained therein. No change in the tender price or other matter of substance in the tender shall be sought, offered or permitted, except as provided in subparagraph (b).

(b) The procuring entity shall correct purely arithmetical errors discovered in a tender. Any such correction shall be binding on the contractor or supplier that submitted the tender if accepted by that contractor or supplier.

(2) The procuring entity shall reject a tender:

- (a) if the contractor or supplier that submitted the tender is not eligible [, subject to article 8(4),] or is not qualified to perform the procurement contract;
- (b) if the contractor or supplier submitted the tender does not accept a correction of an arithmetical error made pursuant to paragraph (1)(b);

(c) if the tender is not responsive, except as provided in paragraph (6) of this article and in article 29(1)(a).

(3) Subject to approval, the procuring entity may reject a tender if the contractor or supplier that submitted it attempts improperly to influence the procuring entity in the process of examining, evaluating or comparing tenders or ascertaining the most advantageous tender.

(4)(a) A tender is responsive if it conforms to the required characteristics of the goods or construction to be procured, contractual terms and conditions and other requirements set forth in the procurement documents. However, the procuring entity may regard a tender as responsive if it contains only minor deviations that do not materially alter or depart from those characteristics, terms, conditions and other requirements. Those permitted deviations shall be quantified and appropriately taken account of in the evaluation and comparison of tenders.

(b) Alterations of or departures from required characteristics, terms, conditions and other requirements of the procurement documents are material if they concern, among other things, the nature and technical and quality characteristics of the goods or construction; the quantity of the goods; the location where the construction is to be effected; the time when the construction is to be completed; the place or time when the goods are to be delivered; the terms of the procurement contract relating to the price or payment thereof; the extent of liability of one party to the other; the settlement of disputes; the tender security; the security for performance of the procurement contract; or the quality guarantee in respect of the goods or construction.

[(5) If the procurement documents solicit tenders for alternatives to the characteristics of the goods or construction, contractual terms and conditions or other requirements set forth in the procurement documents, the procuring entity shall evaluate and compare such alternative tenders together with the tenders based on the characteristics, contractual terms and conditions and other requirements set forth in the procurement documents in order to ascertain the most advantageous tender.]

(6) [Alternative 1]

[A contractor or supplier wishing to submit an unsolicited tender for an alternative to the technical characteristics of the goods or construction set forth in the procurement documents must also submit a tender conforming to the technical characteristics set forth in the procurement documents. An alternative tender may be considered by the procuring entity only if it was submitted by the contractor or supplier whose tender based on the technical characteristics set forth in the procurement documents has been found to be the most advantageous of such tenders.]

[Alternative 2]

[The procuring entity may consider an unsolicited tender for an alternative to the technical characteristics of the goods or construction set forth in the procurement documents if a reasonable opportunity is provided to all eligible and qualified contractors and suppliers that have submitted tenders conforming to the technical characteristics set forth in the procurement documents to alter their

tenders or to submit additional tenders based on the alternative tender. The procuring entity shall evaluate and compare the alternative, altered and additional tenders together with the unaltered tenders in order to ascertain the most advantageous tender.]

(7)(a) The procuring entity shall evaluate and compare tenders that have not been rejected pursuant to paragraph (2) or (3) in order to ascertain the most advantageous tender in accordance with the procedures and criteria set forth in the procurement documents.

(b) The evaluation and comparison of tenders shall be carried out in an objective manner.

(c) The most advantageous tender shall be either:

(i) the tender with the lowest tender price, subject to any margin of preference applied pursuant to subparagraph (e) of this paragraph, or

(ii) the most economically advantageous tender, which shall be ascertained on the basis of objective and quantifiable criteria, to the extent possible, including, in addition to the tender price, subject to any margin of preference applied pursuant to subparagraph (e) of this paragraph, such criteria as: the costs of operating, maintaining and repairing the goods or construction over its expected useful life; the functional characteristics of the goods or construction; the efficiency and productivity of the goods or construction; the time for delivery of the goods or completion of the construction; the terms of payment; and the terms and conditions of the quality guarantee in respect of the goods or construction; in so far as such criteria are not the subjects of required characteristics of the goods or construction or required contractual terms or conditions set forth in the procurement documents.

[(d) In addition to criteria of the nature referred to in subparagraph (c)(ii) of this paragraph, the procuring entity may apply criteria directed to ascertaining the impact of tenders in relation to specific Government programmes or policies for the promotion of national economic development, economic development of particular regions within [this State] or development of particular industries or economic sectors. To the extent possible, such criteria shall be expressed in the procurement documents in objective and quantifiable terms.]

(e) In evaluating and comparing tenders, a procuring entity may grant a margin of preference for the benefit of tenders for construction by domestic contractors and suppliers or for the benefit of tenders for domestically produced goods. The margin of preference shall be applied by adding to the tender prices of all tenders other than those that are to benefit from the margin of preference the amount provided for in the procurement regulations.

(8) When tender prices are expressed in two or more currencies, the tender prices shall be converted to a single currency for the purpose of evaluating and comparing tenders.

(9) Information relating to the examination, clarification, evaluation and comparison of tenders shall not be disclosed to contractors or suppliers or to any other person

not officially involved in the examination, evaluation or comparison of tenders or in the decision of which tender should be accepted, except as provided in article 33(2).

[(10) The ascertainment by the procuring entity of the most advantageous tender is subject to approval.]

#### Article 29. *Rejection of all tenders*

(1) Subject to approval, the procuring entity may, at any time prior to the entry into force of the procurement contract, reject all tenders for any reason other than those set forth in article 28(2) or (3). However, the procuring entity may not reject all tenders for the purpose of invoking article 7(2)(b)(i) or for any fraudulent purpose.

(2) The procuring entity shall incur no liability, solely by virtue of its invoking paragraph (1), towards contractors and suppliers that have submitted tenders nor any obligation to inform them of the grounds for its action.

(3) Notice of the rejection of all tenders pursuant to this article shall be given promptly, in writing or by any other means that provides a record of the information contained therein, to all contractors and suppliers that submitted tenders.

#### Article 30. *Negotiations with contractors and suppliers*

(1) No negotiations shall take place between the procuring entity and a contractor or suppliers with respect to a tender submitted by the contractor or supplier except that:

(a) if the procurement documents specify a maximum price for the goods or construction or a range of prices within which tender prices must fall, and all otherwise responsive tenders from eligible and qualified contractors and suppliers exceed that maximum price or range or prices, the procuring entity may negotiate with the contractor or supplier submitting the tender with the lowest price with a view towards reducing its tender price;

(b) if it appears from the evaluation and comparison of tenders that no one tender is obviously the most advantageous, the procuring entity may negotiate with contractors and suppliers whose tenders appear to be more advantageous than others with a view towards the modification of one of those tenders so that it is more advantageous than the others.

(2) No negotiations permitted by paragraph (1) shall take place concerning any required characteristics of the goods or construction, or any required contractual term or condition, set forth in the procurement documents.

#### Section VIII. *Special tendering procedures for solicitation of proposals*

##### Article 31. *Special tendering procedures for solicitation of proposals*

(1) Subject to approval, the procuring entity may employ the procedures provided for in this article in cases where

it seeks proposals from contractors and suppliers with respect to the technical characteristics of the goods or construction to be procured because multiple alternative technical solutions might meet the needs of the procuring entity or because, due to the nature of the goods or construction, the procuring entity is unable to formulate detailed technical characteristics.

(2) The provisions of chapter II of this Law shall apply to tendering proceedings in which the procedures provided for in the present article are employed except to the extent those provisions are derogated from in the present article.

(3) The procurement documents shall call upon contractors and suppliers to submit initial tenders containing their proposals without a tender price.

(4) The procuring entity may engage in discussions with any contractor or supplier whose tender has not been rejected pursuant to article 28(2) or (3) or 29 concerning any aspect of its tender, other than a required characteristic of the goods or construction or a required contractual term or condition set forth in the procurement documents.

(5) The procuring entity shall invite contractors and suppliers whose tenders have not been rejected to submit final tenders with prices. A contractor or supplier not wishing to submit a final tender may withdraw from the tendering proceedings without forfeiting its tender security. The final tenders shall be evaluated and compared in order to ascertain the most advantageous tender.

(6) The procuring entity shall include in the minutes required under article 33 a statement of the circumstances on which it relied in invoking the provisions of this article, specifying the relevant facts.

**Section IX. Acceptance of tender and entry into force of procurement contract; minutes of tendering proceedings**

**Article 32. Acceptance of tender and entry into force of procurement contract**

(1) [Subject to approval,] the tender that has been ascertained to be the most advantageous shall be accepted. Notice of acceptance of the tender shall be given promptly to the contractor or supplier that submitted the tender.

(2) A procurement contract in accordance with the terms and conditions of the accepted tender enters into force when the notice referred to in paragraph (1) is [dispatched to] [received by] the contractor or supplier that submitted the tender, provided that it is [dispatched] [received] while the tender is in force and effect.

(3)(a) Notwithstanding the provisions of paragraph (2), the notice referred to in paragraph (1) may require the contractor or supplier whose tender has been accepted to sign a written procurement contract conforming to the tender. The contractor or supplier shall sign the written procurement contract within a reasonable period of time after the notice is [dispatched to] [received by] it.

(b) The procurement contract enters into force when the written procurement contract is signed by the contractor or supplier and by the procuring entity. Between

the time when the notice referred to in paragraph (1) is [dispatched to] [received by] the contractor or supplier until the entry into force of the procurement contract, the contractor or supplier shall take no action which interferes with the entry into force of the procurement contract or with its performance.

(4) If the contractor or supplier whose tender has been accepted fails to sign a written procurement contract, if required to do so, or fails to provide any required security for the performance of the contract, the tender that is ascertained to be the next most advantageous tender and that is in force and effect may be accepted [, subject to approval]. The notice provided for in paragraph (1) shall be given to the contractor or supplier that submitted that tender.

(5) Upon the entry into force of the procurement contract and the provision by the contractor or supplier of a security for the performance of the contract, if required, notice of the procurement contract shall be given to other contractors and suppliers, specifying the name and address of the contractor or supplier that has entered into the contract and the price of the contract.

(6)(a) The notices referred to in this article may be given in writing or by any other means that provides a record of the information contained therein.

(b) [Alternative 1: The notice under paragraph (1) is "dispatched" when it is properly addressed or otherwise directed and transmitted to the contractor or supplier, or conveyed to an appropriate authority for transmission to the contractor or supplier, by a mode authorized by paragraph (6)(a).]

[Alternative 2: The notice referred to in paragraph (1) is "received" by the contractor or supplier when it is received by it personally or at its place of business or mailing address.]

**Article 33. Minutes of tendering proceedings**

(1) The procuring entity shall prepare minutes of the tendering proceedings, including the opening, examination, evaluation and comparison of tenders. The minutes shall contain a brief description of the goods or construction to be procured, the names and addresses of contractors and suppliers that submitted tenders; information relative to the eligibility and qualifications, or lack thereof, of those contractors and suppliers; the price and a summary of the other principal terms and conditions of each tender and of the procurement contract; a summary of the evaluation and comparison of tenders; if all tenders were rejected pursuant to article 29, a statement to that effect; and, where applicable, the statement required by article 31(6).

(2) The minutes of the tendering proceedings shall be made available for inspection by the general public after a procurement contract has entered into force and the contractor or supplier has supplied a security for the performance of the contract, if required, or after tendering proceedings have been terminated without resulting in a procurement contract. However, no information shall be disclosed contrary to any law of [this State] relating to confidentiality.

**Chapter III. Procurement other than by means of tendering proceedings**

**Article 34. Competitive negotiation proceedings**

(1) In competitive negotiation proceedings, the procuring entity shall engage in negotiations with a sufficient number of contractors and supplier to ensure effective competition, but in any case with at least [3] contractors and suppliers unless negotiations with [3] contractors and suppliers are not possible or are not practicable.

(2) Any requirements, guidelines, documents or other information relative to the negotiations that are communicated by the procuring entity to a contractor or supplier shall be communicated on an equal basis to all other contractors and suppliers engaging in negotiations with the procuring entity relative to the procurement; provided, however, that the foregoing provision shall not apply to documents or other information that is particular to negotiations with an individual contractor or supplier or to documents or information the disclosure of which would be contrary to any law of [this State] relating to confidentiality.

(3) Negotiations between the procuring entity and a contractor or supplier shall be confidential, and except as provided in paragraph (4), one party to those negotiations shall not reveal or disclose to any third person any documentation or information relating to those negotiations without the consent of the other party.

(4)(a) The procuring entity shall prepare minutes of the competitive negotiation proceedings. The minutes shall contain the names and addresses of contractors and suppliers with which the procuring entity has engaged in negotiations; the price and a summary of the other principal terms and conditions of the procurement contract; if the proceedings did not result in a procurement contract, a statement of the reasons therefor; and the statement and facts required by article 7(5).

(b) The minutes of the competitive negotiation proceedings shall be made available for inspection by the general public after a procurement contract has entered into force, except that no information shall be disclosed contrary to any law of [this State] relating to confidentiality.

**Article 35. Record of single source procurement**

(1) The procuring entity shall prepare a record of the single source procurement. The record shall contain the name and address of the contractor or supplier from which the procuring entity procured the goods or construction, the price and a summary of the other principal terms and conditions of the procurement contract and the statement and facts required by article 7(5).

(2) The record shall be made available for inspection by the general public after the procurement contract has entered into force; provided, however, that no information shall be disclosed contrary to any law of [this State] relating to confidentiality.

**C. Procurement: commentary on draft model law on procurement: report of the Secretary-General\* (A/CN.9/WG.V/WP.25) [Original: English]**

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\*Working paper submitted to the Working Group on the New International Economic Order at its eleventh session.

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## INTRODUCTION

1. The draft model law on procurement is intended to serve as a model to countries for the evaluation and improvement of their procurement laws and practices and for the establishment of procurement laws where none presently exist. Sound laws and practices for public sector procurement are necessary in all countries. The need is particularly prominent in many developing countries. In those countries, a substantial portion of all procurement is engaged in by the public sector. Much of such procurement is in connection with projects that are part of the essential process of economic and social development. Those countries in particular suffer from a shortage of public funds to be used for procurement. It is thus critical that procurement be carried out in the most advantageous way possible.

2. The present document contains the commentary prepared by the Secretariat to accompany the draft model law on procurement, the text of which is contained in document A/CN.9/WG.V/WP.24. To facilitate the examination and discussion of the commentary the text of each draft article has been placed immediately preceding the commentary that relates to it.

3. The commentary contains notes within square brackets, designated as "Working Group notes", that are intended for the information and guidance of the Working Group in considering the draft text. They would not appear in the final version of the commentary to the model law, if one were to be adopted by the Commission.

4. The following abbreviated names are used in the references contained in the "Working Group notes".

*EEC Directives*—Council Directive of 21 December 1976 concerning the award of public supply contracts (77/62/EEC) as amended by Council Directive of 22 July 1980 (80/767/EEC) and Council Directive of 22 March 1988 (88/295/EEC)

*GATT Procurement Agreement*—GATT Agreement on Government Procurement;

*UNCITRAL Construction Legal Guide*—UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works.

*United Nations Sales Convention*—United Nations Convention on Contracts for the International Sale of Goods.

## DRAFT MODEL LAW ON PROCUREMENT AND COMMENTARY

### Chapter I. General provisions

#### Article 1. Application of Law\*

This Law applies to procurement by procuring entities of goods, through such means as purchase, rental or

otherwise, or of construction. The procurement shall be considered to be a procurement of goods or of construction where the goods or construction constitute a substantial part of the procurement.

#### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 12, 13, 42; A/CN.9/315, para. 25]

1. The model law applies regardless of the value of the procurement.

[Working Group note: rather than excluding low value contracts from the application of the model law, the approach followed in this draft is to give the procuring entity a high degree of flexibility with respect to the procedures to be followed for the formation and entry into existence of those contracts (see articles 34 and 35 and accompanying commentary), but to subject even those contracts to basic legal rules (e.g., articles 7, 8, 9, 34 and 35).]

2. The model law applies where goods or construction constitute a "substantial part" of the procurement. This includes, for example, not only procurement by means of simple sales contracts or basic construction contracts, but also by means of contracts in which the contractor or supplier undertakes obligations in addition to furnishing goods or construction, such as obligations to grant a licence, to prepare a design, to perform architectural or civil engineering services, to transfer technology to the procuring entity or to train the procuring entity's personnel to operate equipment or works furnished by the contractor or supplier. Thus, the model law applies, for example to turnkey contracts for the construction of industrial works. On the other hand, the model law does not apply to the procurement of services (e.g., design, architectural or civil engineering services, insurance, financial services, advertising), of intangible rights interests (e.g., franchises, licences, financial instruments) or of ownership or other interests in real estate, where goods or construction do not constitute a substantial part of the procurement. An implementing State may wish to provide by means of the procurement regulations detailed rules for determining when goods or construction constitute a "substantial part" of the procurement (see article 4).

[Working Group note: the Working Group has decided not to deal with the procurement of services alone at the "present stage" (A/CN.9/315, para. 25). At an appropriate time it may wish to prepare model legislation for services.]

3. The terms "procuring entity", "goods" and "construction" are defined in article 2.

#### Article 2. Definitions

For the purposes of this Law:

(a) "procuring entity" means:

(i) any department, agency, organ or other unit, or any subdivision thereof, of the Government or the administration;

(ii) [each State enacting this model law inserts in this subparagraph and, if necessary, in subsequent

\*Article headings are for reference purposes only and are not to be used for purposes of interpretation.

subparagraphs, other entities or enterprises, or categories thereof, to be included in the definition of "procuring entity"].

(b) "goods" includes raw materials, products, equipment and other tangible objects of every kind and description;

(c) "construction" means such physical work as site preparation, excavation, erection, building, installation of equipment or materials, decoration and finishing, in respect of a new structure or of an existing structure;

(d) "procurement proceedings" means proceedings engaged in or measures taken by a procuring entity with a view towards entering into a procurement contract, including tendering proceedings, competitive negotiation proceedings and single source procurement;

(e) "International tendering proceedings" means the proceedings referred to in article 11, for which chapter II of this Law requires the application of particular procedures with a view towards promoting international participation in the tendering proceedings;

(f) "Tender security" includes such arrangements as bank guarantees, letters of credit, cheques on which a bank is primarily liable and cash deposits, provided by a contractor or supplier to secure obligations in respect of its tender;

(g) "Currency" includes unit of account;

(h) "Competitive negotiation proceedings" means negotiations by the procuring entity with contractors and suppliers with a view towards procurement, such negotiations being subject to rules set forth in article 34 designed to incorporate a competitive element;

(i) "Single source procurement" means procurement from a particular contractor or supplier without engaging in tendering proceedings or competitive negotiation proceedings.

#### Commentary

Subparagraph (a): "Procuring entity"

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 39-41; A/CN.9/315, paras. 21-24]

1. The model law is intended to cover primarily procurement by governmental units and other entities and enterprises within the public sector. Whether the model law should also cover procurement by units of provincial, local or other governmental subdivisions of the State depends to a certain degree on the allocation of governmental competence within the State. If an implementing State wished, the model law could also be made applicable to procurement with public funds by certain entities or enterprises outside the public sector.

2. Subparagraph (i) brings within the scope of the model law departments, agencies, organs and other units of the central Government of the State. The subparagraph refers both to the "Government" and to the "administration" of the State because, in some systems, there is a distinction between the two and because there exist in some countries

agencies within the State administration that are structurally autonomous of the Government. Public sector entities and enterprises that are not considered part of the Government or the administration of the State, governmental subdivisions of the State, and any entities or enterprises outside the public sector that the implementing State wished to cover, could be brought within the coverage of the model law by specifically referring to them in subparagraph (ii) and, if necessary, in subsequent subparagraphs. An implementing State could either set forth the categories of entities and enterprises to be covered or it could specify the particular entities and enterprises to be covered. In that connection, implementing States may wish to consider one or more of the following factors as relevant to the question of which entities and enterprises or categories thereof to include:

(a) whether the Government or the administration provides public funds to the entity (e.g., ordinary appropriations of public funds to the operating or capital budgets of the entity; subsidies from public funds to cover deficits incurred by entities that are organized on a non-profit or non-self-supporting basis; extraordinary appropriations of public funds, e.g., to rescue an entity in financial difficulty; *ad hoc* appropriations of public funds to be used by the entity for a particular purpose, such as agricultural or industrial development grants);

(b) whether the Government or the administration provides a guarantee or other security to secure payment by the entity in connection with its procurement contract, or otherwise bears the obligations of the procuring entity under the contract;

(c) whether the entity is managed or controlled by the Government or the administration or whether the Government or the administration participates in the management or control of the entity (e.g., whether some or all of the managers or directors of the entity are civil servants or are appointed by the Government or the administration; whether the operations of the entity are in other ways subject to the control or supervision of the Government or the administration; or whether the operations of the entity are autonomous but are subject to the overall policies of the Government or the administration);

(d) whether the Government or the administration grants to the entity an exclusive licence, monopoly or quasi-monopoly for the sale of the goods that the entity sells or the services that it provides;

(e) whether the Government or the administration audits the finances or operations of the entity;

(f) whether the entity is accountable to the Government or to the public treasury in respect of the profitability of the entity;

(g) whether an international agreement or other international obligation of the State applies to procurement engaged in by the entity;

(h) whether public law applies to procurement contracts entered into by the entity;

(i) whether the entity has been created by statute;

(j) whether the entity is integrated within a centralized economic plan;



(k) whether the entity performs its activities in the furtherance of a legally-mandated obligation or other public purpose.

3. The above criteria in essence present possible interests of the State in requiring certain entities or categories thereof to conduct their procurement in accordance with the procedures provided by the model law. Criterion (a) involves the interest of the State in ensuring that entities which it supports financially engage in their procurement with economy and efficiency. Under criterion (b) the State has an interest in ensuring that the purchase price, the payment of which it guarantees, is economical. The interest of the State reflected in criterion (c) is to promote public confidence in and the integrity of the public sector by ensuring that procurement engaged in by entities that are subject to State management or control is conducted fairly and properly.

4. Criterion (d) addresses the problem that, when an entity is granted an exclusive license, monopoly or quasi-monopoly, the prices of the goods that it sells or the services that it provides are subject to few competitive constraints, and therefore it may have less commercial incentive to procure economically and efficiently than does an entity that sells its goods or services in a competitive environment. Since the State has created the monopolistic situation, it might consider that it has an interest in or responsibility for seeing to it that the entity nevertheless procures with economy and efficiency. The remaining criteria involve additional indications that an entity is within the public domain and thus possibly appropriate for inclusion within the scope of application of the model law.

*Subparagraph (c): "Construction"*

5. "Construction" is defined in this subparagraph by means of an illustrative list of activities. The term includes the construction of such things as roads, dams, buildings, and industrial works (e.g., factories; fertilizer plants; hydroelectrical plants). The construction may be performed in respect of a new structure or in respect of an existing one (e.g., to alter, renovate or add to an existing structure). The definition includes only "physical" work; it does not include preparation of the design or supervision of construction (although, if a "substantial part" of the contract is for the acquisition of physical work of the nature indicated in the definition, it will be a "construction contract" even if those non-physical services are included; see paragraph 2 of commentary to article 1). [Working Group note: the terms, "building", "installation", "decoration" and "finishing" are derived from the List of Professional Trade Activities as set out in the Nomenclature of Industries in the European Communities (NICE), major group 40, "Construction", annexed to Council Directive of 26 July 1971 (C71/304/EEC) (*Official Journal of the European Communities*, No. L 185/1), (concerning the award of public works contracts).]

*Subparagraph (e): "International tendering proceedings"*

6. In tendering proceedings where it is sought to promote international participation, the procuring entity must employ certain procedures designed to be conducive to that participation (see commentary to article 11). The

question of when international tendering proceedings are to be engaged in is dealt with in article 11.

*Article 3. Underlying policies*

(1) The underlying policies of this Law are:

- (a) to maximize economy and efficiency in procurement;
- (b) to foster and encourage participation in procurement proceedings by competent contractors and suppliers, including, where appropriate, international participation;
- (c) to promote competition among contractors and suppliers for the supply of the goods or construction to be procured;
- (d) to provide for the fair and equitable treatment of all contractors and suppliers in connection with procurement covered by this Law;
- (e) to promote the integrity of, and fairness and public confidence, in the procurement process; and
- (f) to achieve transparency in the procedures relating to procurement.

(2) This Law is subject to any international agreement, or any agreement with or other obligation towards an international institution or a governmental institution of another State, which has already been or may be entered into by [this State] and which contains provisions concerning the matters governed by this Law.

*Commentary*

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 15-27; A/CN.9/315, paras. 9, 13-16, 122]

*Paragraph (1)*

1. The policies set forth in this paragraph serve as guidance in the interpretation and application of the model law; they do not themselves create substantive rights or obligations for procuring entities or for contractors or suppliers. The substantive provisions of the model law have been formulated with the objective of maximizing the possibility of achieving those policies and minimizing possible conflicts between them.

*Subparagraphs (a), (b) and (c)*

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 16-20]

2. Economy and efficiency in expenditure of public funds are important to all countries. Economy refers to the procurement of goods or construction of the desired quality at the most advantageous price and upon the most advantageous contractual terms. It is promoted by procedures that provide a favourable climate for participation in procurement proceedings by competent contractors or suppliers, and that provide incentives to them to offer their most advantageous quality, price and other terms.

3. Efficiency in procurement is also an important policy underlying the model law since inefficient procurement procedures can delay the procurement and can unneces-

sarily add to the cost of administering the procurement proceedings by the procuring entity.

4. Two additional policies of the model law are to foster and encourage participation by competent contractors and suppliers in procurement proceedings and to promote competition among them. Competition can maximize economy in procurement by inducing contractors and suppliers to make their most advantageous offers. The broader the range of participation in procurement proceedings the more effective will be the competition and the greater will be the likelihood that the procuring entity will be able to obtain the most satisfactory terms.

5. The policy of fostering and encouraging international participation in procurement proceedings, where appropriate, is aimed at further enhancing the conditions leading to economy in procurement. (With respect to when foreign participation is "appropriate", see the commentary to article 11.) Foreign participation can expand the competitive base. In addition, it can lead to the acquisition by the procuring entity and its country of technologies that are not available locally. Foreign participation in procurement proceedings may be necessary where there exist no domestic sources for certain works or goods needed by the procuring entity. [*Working Group note*: see A/CN.9/315, paras. 9 and 122]. However, the model law recognizes the possibility of according preferential treatment to domestic contractors and suppliers in some cases in order to advance other economic objectives (see article 28(7)(d) and (e)).

#### *Subparagraphs (d) and (e)*

[*Working Group note*: sources: A/CN.9/WG.V/WP.22, paras. 21, 22; A/CN.9/315, para. 15]

6. Other important policies underlying the model law are to provide for fair and equitable treatment of all contractors and suppliers in connection with procurement covered by the Law and to promote the integrity of, and fairness and public confidence in, the procurement process. Thus, for example, the model law seeks to reduce misapplications and abuses of the procurement process by persons administering it and by contractors or suppliers participating in it (e.g., collusive tendering), and to ensure that procurement decisions are taken on a proper basis.

7. Promoting the integrity of the procurement process will help to promote public confidence in the process and in the public sector in general. Confidence in the procurement process on the part of competent contractors and suppliers is necessary for their participation in procurement proceedings, and thus for the achievement of economy in procurement.

#### *Subparagraph (f)*

[*Working Group note*: sources: A/CN.9/WG.V/WP.22, paras. 26, 27]

8. The policy of achieving transparency in procurement laws and procedures is directed at helping to achieve other policy objectives already mentioned. Transparent laws are those in which the rules and procedures to be followed by the procuring entity and by contractors and suppliers par-

ticipating in the procurement proceedings are fully disclosed, particularly to the participants and potential participants. Transparent procedures are those that enable participants to ascertain what procedures have been or will be followed by the procuring entity and the basis of decisions taken by the procuring entity.

9. Transparent procurement laws and procedures create predictability, enabling contractors and suppliers to calculate the costs and risks of their participation in procurement proceedings and thus to offer their most economical prices. They also help to guard against arbitrary or improper actions or decisions by the procuring entity or its officials and thus help to promote confidence in the procurement process. Transparency of procurement laws and procedures is of particular importance where foreign participation in procurement is sought, since foreign contractors and suppliers may be unfamiliar with a country's procurement practices.

#### *Paragraph (2)*

[*Working Group note*: sources: A/CN.9/WG.V/WP.22, paras. 9, 10, 38; the wording of the paragraph is adapted from article 90 of the United Nations Sales Convention.]

10. An implementing State may be subject to certain international agreements or obligations with respect to procurement. For example, a number of States and the European Economic Community (EEC) are parties to the GATT Procurement Agreement, and EEC members are bound by directives on procurement adopted by the Council of the EEC. In addition, many international lending institutions and national development funding agencies have established guidelines or rules governing procurement with funds provided by them. In their loan or funding agreements with those institutions and agencies, borrowing or recipient countries undertake that proceedings for procurement with those funds will conform to the guidelines or rules. Pursuant to paragraph (2) of the present article, if there is a conflict between a provision of the model law and the requirements under an applicable international agreement or other international obligation of the implementing State, the requirements of the international agreement or other international obligation are to be applied; but in all other respects the procurement is to be governed by the model law.

11. The model law is not subordinated to agreements with or obligations towards non-governmental institutions of another State (e.g., non-governmental commercial banks).

#### *Article 4. Procurement regulations*

The . . . [each State enacting this model law specifies the organ or authority authorized to promulgate the procurement regulations] is authorized to promulgate procurement regulations to elaborate upon or supplement this Law.

#### *Commentary*

[*Working Group note*: sources: A/CN.9/WG.V/WP.22, paras. 30-34, 230, 231; A/CN.9/315, paras. 8, 10]

1. The model law is a "framework law"; that is, it sets forth basic legal rules governing procurement which are intended to be supplemented by detailed regulations promulgated by the appropriate organ or authority of the implementing State (see commentary to article 6). The "framework law" technique enables an implementing State to tailor its detailed rules governing procurement procedures to its own particular needs and circumstances within the overall framework established by the Law.

2. Various provisions of the model law expressly provide for the elaboration or supplementation of those provisions by procurement regulations. Regulations may also be promulgated concerning other matters dealt with by the model law. In both cases, the regulations must be consistent with the model law.

*Article 5. Public accessibility of procurement law, procurement regulations and other legal texts relating to procurement*

This Law and the procurement regulations, all administrative rulings and directives of general application in connection with procurement covered by this Law, and all amendments of this Law and those regulations and administrative rulings and directives, shall be promptly made accessible to the public.

*Commentary*

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 26, 27, 36, 37; A/CN.9/315, para. 20]

1. This article is intended to promote transparency in the laws, regulations and other legal texts relating to procurement. [Working Group note: the language is broadly based upon article VI(2) of the GATT Procurement Agreement.] In many countries there exist official publications in which laws, regulations and administrative rulings and directives are routinely published. The texts referred to in the present article could be expected to be published in those publications. Where there do not exist publications for one or more of those categories of texts, the texts should be promptly made accessible to the public, including foreign contractors and suppliers, in an appropriate manner.

2. Although the present article does not require it, it would be useful for participants or potential participants in procurement proceedings, especially those from foreign countries, for the laws, regulations and other texts relating to procurement to be collected and published in a single publication made available to interested persons at a reasonable cost (e.g., the cost of publishing and distributing the publication).

3. The article requires administrative rulings and directives "of general application" to be made accessible to the public. The requirement does not apply to administrative rulings and directives that are directed to or concern individual contractors or suppliers.

*Article 6. Control and supervision of procurement*

(1) The approval function referred to in articles 7(2), 7(3), 11(2), 12(2), 28(3), 28(10), 29(1), 31(1), [32(1),

and] [32(4)] shall be performed by ... [each State enacting this model law specifies the organ or authority authorized to perform the approval function.]

(2) [Each State enacting this model law specifies in this paragraph and, if necessary, in subsequent paragraphs, any additional functions in connection with the control and supervision of procurement and the organ[s] or authority[ies] to perform those functions.]

*Commentary*

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 43-53; A/CN.9/315, paras. 26-28]

1. With respect to paragraph (1), the approval function may be vested in an organ or authority that is wholly autonomous of the procuring entity (e.g. a ministry of finance or of commerce, or a central procurement board) or, alternatively, it may be vested in a separate supervisory organ of the procuring entity itself. In the case of procuring entities that are autonomous of the governmental or administrative structure of the State, such as some State-owned commercial enterprises, countries may find it preferable for the approval function to be exercised by an organ or authority that is part of the governmental or administrative apparatus in order to ensure that the public policies that are sought to be advanced by the model law are given due effect. In any case, it is important that the organ or authority be sufficiently independent of the persons or department conducting or involved in the procurement proceedings, to be able to exercise its functions impartially and effectively. It may be preferable for the approval function to be exercised by a committee of persons, rather than by one single person.

2. In addition to designating the organ or authority to perform the approval function referred to in the preceding paragraph, an implementing State may find it desirable to provide for functions directed to the overall supervision of and control over procurement to which the model law applies. All of those functions might be vested in a single organ or authority (e.g., a ministry of finance or of commerce, or a central procurement board), or they may be allocated among two or more organs or authorities. The functions might include, for example, some or all of those mentioned below.

(a) *Supervising overall implementation of procurement law and regulations.* This may include, for example, monitoring implementation of the procurement law and regulations and making recommendations for their improvement. It may also include issuing interpretations of those laws. In some cases, e.g., in the case of high value procurement contracts, the organ might be empowered to review the procurement proceedings to ensure that they have conformed to the model law and to the procurement regulations, before the contract can enter into existence.

(b) *Rationalization and standardization of procurement and procurement practices.* This may include, for example, co-ordinating procurement by procuring entities, and preparing standardized procurement documents, specifications and conditions of contract.

(c) *Monitoring procurement and the functioning of the procurement law and regulations from the standpoint of broader Government policies.* This may include, for example, examining the impact of procurement on the national economy, rendering advice on the effect of particular procurements on prices and other economic factors, and verifying that a particular procurement falls within the programmes and policies of the Government.

3. The organ or authority to exercise such functions in a particular implementing State, and the precise functions that the organ or authority is to exercise, will depend, for example, on the governmental, administrative and legal systems in the State, which vary widely from country to country. Each implementing State should formulate its own provisions taking into account its own circumstances, aided by the present commentary. It would be highly desirable for all such provisions to be contained in article 6, so as not to alter the numbering of the articles of the model law.

4. The system of administrative control over procurement should be structured with the objectives of economy and efficiency in mind, since systems that are excessively costly or burdensome either to the procuring entity or to participants in procurement proceedings, or that result in undue delays in procurement, will be counterproductive. In addition, excessive control over decision-making by officials who carry out the procurement proceedings could in some cases stifle their ability to act effectively.

#### Article 7. *Methods of procurement and conditions for their use*

(1) Except as otherwise provided by this Law, a procuring entity engaging in procurement shall do so by means of tendering proceedings.

(2) Subject to approval, the procuring entity may engage in procurement by means of competitive negotiation proceedings when:

(a) the price of the procurement contract is less than the amount set forth in the procurement regulations; or

(b) tendering proceedings have been engaged in but:

(i) all tenders were rejected by the procuring entity pursuant to article 28(2) or (3) or article 29; or

(ii) the contractor or supplier whose tender has been accepted fails to sign a procurement contract with the procuring entity when required to do so or fails to supply a required security for the performance of the contract, and no other responsive tender from an eligible and qualified contractor or supplier is in effect.

(3) Subject to approval, the procuring entity may engage in single source procurement when:

(a) the price of the procurement contract is less than the amount set forth in the procurement regulations;

(b) the goods or construction is available only from the particular contractor or supplier or no reasonable alternative or substitute exists;

(c) there is an urgent need for the goods or construction making it impossible or imprudent to use tendering proceedings or competitive negotiation proceedings, as the case may be, because of the amount of time involved in using those proceedings;

(d) for reasons of standardization, or the need for compatibility with existing equipment or technology, goods must be procured from a particular contractor or supplier;

(e) the procuring entity seeks to enter into a contract with the contractor or supplier for the purpose of research, experiment, study or development, except where the contract includes the production of goods in quantities to establish their commercial viability or to recover research and development costs; or

(f) for reasons of national security there is a need for secrecy in respect of the procuring entity's procurement needs.

(4) The procuring entity shall not divide its procurement of the goods or construction into separate contracts for the purpose of invoking paragraph (2)(a) or (3)(a).

(5) A procuring entity that invokes the provisions of paragraph (2) or (3) shall include in the minutes required under article 34(4) or the record required under article 35 a statement of the circumstances on which it relied and, except in respect of paragraph (3)(f), shall specify the relevant facts.

#### *Commentary*

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 56-74; A/CN.9/315, paras. 29-34, 110, 113]

#### *Paragraph (1)*

1. The model law requires procuring entities to use tendering proceedings for their procurement, except in the circumstances specified in paragraphs (2) and (3) of the present article. This is because, in general, tendering proceedings maximize economy and efficiency as well as the integrity of and confidence in the procurement process, thus promoting underlying policies of the model law (article 3(1)). The specified circumstances in which methods other than tendering proceedings may be used are, in principle, ones in which the use of tendering proceedings would be impracticable or imprudent or would otherwise not be best suited for pursuing the policies referred to in article 3(1). The use of methods other than tendering proceedings requires approval (see paragraph 1 of commentary to article 6).

[Working Group note: the approach adopted in this article, under which the procuring entity must use tendering proceedings except in specified cases, was the approach ultimately settled on by the Working Group at its tenth session (A/CN.9/315, paras. 32, 110 (especially last sentence) and 113 (especially last sentence)). Another approach that received support in the Working Group was that the model law should provide for various methods of procurement

and enable the procuring entity to use whichever method it deemed to be most appropriate for a particular procurement, and should set forth criteria to guide procuring entities in making that choice (A/CN.9/315, paras. 33 and 34). For the possible consideration of the Working Group, language reflecting that approach is set forth below.

["(1) The procuring entity shall engage in procurement by whichever of the following methods it deems to be most appropriate, taking into consideration the circumstances of the procurement:

- (a) tendering proceedings,
- (b) competitive negotiation proceedings, or
- (c) single source procurement proceedings.

["(2) In choosing the method of procurement to use the procuring entity shall:

- (a) seek to maximize the promotion of the policies set forth in article 3(1); and
- (b) take into account the following considerations:
  - (i) that tendering proceedings provide the greatest degree of competition and in many cases will best promote the policies set forth in article 3(1);
  - (ii) [other criteria to be formulated based on A/CN.9/315, para. 34, and A/CN.9/WG.V/WP.22, paras. 64 to 74.]"]

#### Paragraph (2)

2. "Competitive negotiation proceedings" is defined in article 2(h). The model law permits those proceedings to be used for procurement only in the exceptional circumstances set forth in paragraph (2) of this article. Subparagraph (a) calls for the procurement regulations to stipulate the amount below which competitive negotiation proceedings may be used (see article 4 and accompanying commentary). The principle underlying that subparagraph is that, in respect of procurement below the stipulated amount, the policies set forth in article 3 are less compelling than with respect to procurement over that amount, and the cost and time involved in engaging in tendering proceedings are therefore not justified. The amount set forth in the procurement regulations should be determined in the light of that underlying principle. The procurement regulations might set forth two amounts: one for the procurement of goods and another for the procurement of construction.

3. Subparagraph (b) permits competitive negotiation proceedings to be used when, for the reasons specified, tendering proceedings have not resulted in a procurement contract. Subparagraph (i) is self-explanatory. With respect to subparagraph (ii), if another tender was in effect the procuring entity would be required to accept that tender and would not be permitted to resort to competitive negotiation proceedings. In such a case, the procuring entity would be able to exercise its rights against the failing contractor or supplier (e.g., under a tender security) to cover its losses arising from the failure.

#### Paragraph (3)

4. "Single source procurement" is defined in article 2(i). Procurement by that method is permitted only in the ex-

ceptional circumstances set forth in paragraph (3) of the present article.

5. With respect to subparagraph (a), the comments in paragraph 2 of this commentary (relating to paragraph (2)(a) of the present article) apply by analogy. It is contemplated that the amount referred to in subparagraph (3)(a) would be lower than the amount referred to in paragraph (2)(a).

6. Subparagraph (b) relates, for example, to cases in which the goods or construction required by the procuring entity are unique (e.g., works of art) or are subject to exclusive proprietary rights of the contractor or supplier. Note, however, that, under article 20, the procuring entity must formulate its procurement needs in an objective manner, to the extent possible, so as not to favour particular contractors or suppliers. Subparagraph (c) contemplates cases that are truly exceptional, and not merely cases of convenience.

[Working Group note: the language of subparagraph (e) is adapted from article 6(4)(b) of the EEC Directive.]

7. Subparagraph (f) contemplates cases where public disclosure of the procuring entity's procurement needs, which would be necessary under tendering and competitive negotiation proceedings, would compromise national security.

#### Paragraph (4)

8. The purpose of paragraph (4) is to prevent abuses of paragraphs (2)(a) and (3)(a) by dividing procurement into separate contracts, each with estimated prices below the threshold amounts set forth in the procurement regulations, for the purpose of avoiding the use of tendering proceedings.

#### Paragraph (5)

9. Paragraph (5) provides another safeguard against the improper use of paragraphs (2) and (3) as a means of avoiding the use of tendering proceedings or competitive negotiation proceedings. It also promotes transparency of procurement proceedings. It is not sufficient for a procuring entity merely to re-state one of the justifying circumstances set forth in paragraph (2) or (3); it must also state facts in support thereof, except when invoking the "national security" exception (paragraph (3)(f)).

#### Article 8. Eligibility of contractors and suppliers

(1)(a) The procuring entity may require contractors and suppliers participating in procurement proceedings to provide such appropriate written statements, documentary evidence or other information as it may deem useful to satisfy itself that the contractors and suppliers:

- (i) have legal capacity to enter into the procurement contract;
- (ii) are not insolvent, bankrupt or being wound up, their affairs are not being administered by a court or a judicial officer, their business activities have not been suspended, and they are not the subject of legal proceedings for any of the foregoing;

(iii) have fulfilled their obligations to pay taxes and social security contributions in [this State];

(iv) have not been convicted of any criminal offense concerning their professional conduct within a period of [5] years preceeding the commencement of the procurement proceedings;

(v) [ . . . ] [each State enacting this model law specifies any additional eligibility requirements.]

(b) The procuring entity may, in addition, investigate by any other appropriate means the eligibility of a contractor or supplier pursuant to criteria set forth in subparagraph (a).

(2) Any requirement established pursuant to paragraph (1)(a) and the eligibility criteria set forth in that paragraph shall apply equally to all contractors and suppliers. A procuring entity shall impose no eligibility criterion other than those provided for in paragraph (1)(a).

[(3) A contractor or supplier shall not be precluded from participating in procurement proceedings for the reason that it does not conform to one or more eligibility criteria set forth in paragraph (1) if the contractor or supplier undertakes to establish its conformity during the course of the procurement proceedings and if it is reasonable to expect that the contractor or supplier will be able to do so.]

### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 76-84; A/CN.9/315, paras. 35-39]

1. This article establishes criteria concerning the eligibility of contractors or suppliers. Those criteria are distinct from qualification criteria that a procuring entity may impose pursuant to articles 9 and 15.

2. When tendering proceedings are engaged in, the eligibility criteria contained in paragraph (1)(a) must be set forth in the notice of proposed procurement (article 14(1)(d)), in the prequalification documents (article 16(3)), and in the procurement documents (article 18(b)).

3. In some cases, an implementing State might wish to set forth in the Law additional eligibility criteria (e.g., that contractors and suppliers be enrolled on a commercial, professional or trade register in the State; or that the contractor or supplier has not, within a period of [5] years preceeding the commencement of the procurement proceedings, failed without legal justification to complete the performance of a contract with a procuring entity, or had such a contract terminated for reasons attributable to its fault). Such additional criteria could be set forth in paragraph (1)(a)(v) and subsequent subparagraphs, if needed. Any additional criteria should be restricted to those that are necessary to protect legitimate interests of the State or of the procuring entity, and, in the case of international tendering proceedings, should avoid unnecessary restrictions on or barriers to international participation. For example, a requirement that a contractor or supplier be enrolled on a commercial, professional or trade register should be accompanied by the proviso that, in international tendering proceedings, foreign contractors and

suppliers have an equal opportunity to enroll. Paragraph (1)(a) should set forth all eligibility criteria that may be imposed; see paragraph (2).

4. The procuring entity may decide what type of written statements, documentary evidence or other information to require in particular procurement proceedings. When tendering proceedings are engaged in, such requirements must be specified in the prequalification documents (article 16(3)(d)) and in the procurement documents (article 18(d)). Rules concerning written statements and documentary evidence submitted by contractors and suppliers are set forth in article 10.

5. The required statements, documentation or information must be "appropriate". Its nature will depend on the circumstances of each procurement proceedings, such as the value of the goods or construction to be procured, and whether a broad range of contractors and suppliers that are not familiar to the procuring entity are expected to participate. For example, in proceedings for the procurement of high value equipment or industrial works, a procuring entity might require official certifications (e.g., from court, or tax or other authorities). In single source procurement proceedings for goods of relatively low value, the procuring entity might simply require the contractor or supplier to execute a standard form affidavit to the effect that the contractor or supplier conforms to all eligibility criteria. An intentional misstatement on the affidavit would be subject to sanctions under the applicable law. It is not in the interest of the procuring entity to require documentation beyond that necessary reasonably to satisfy it that the eligibility criteria are met.

[6. The purpose of paragraph (3) is to enable a contractor or supplier to participate in procurement proceedings even though it does not conform to an eligibility criterion or cannot establish its eligibility at the outset of the proceedings, and to give it an opportunity to establish its eligibility during the proceedings. However, it must establish its eligibility before it can enter into a procurement contract with the procuring entity.] [Working Group note: paragraph (3) and the commentary thereto have been placed within square brackets due to the differing views reflected in A/CN.9/315, para. 39.]

### Article 9. *Qualifications of contractors and suppliers*

The procuring entity may require contractors and suppliers participating in procurement proceedings to provide such appropriate written statements, documentary evidence or other information as it may deem useful to satisfy itself that the contractors and suppliers possess sufficient qualifications with respect to technical competence, financial resources, equipment and other physical facilities, and sufficient personnel, to perform the procurement contract. Any such requirement, and any criterion established with respect to those qualifications, shall apply equally to all contractors and suppliers. A procuring entity may, in addition, investigate by any other appropriate means the qualifications of a contractor or supplier.

### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, para. 85, 86; A/CN.9/315, para. 40]

It is essential that the contractor or supplier with which the procuring entity enters into a procurement contract be qualified to perform the contract. Further rules concerning the application of the present article in connection with tendering proceedings are set forth in articles 15 and 16.

#### Article 10. *Rules concerning written statements and documentary evidence provided by contractors and suppliers*

(1) This article applies to written statements and other documentary evidence provided by contractors and suppliers to demonstrate their eligibility and qualifications in procurement proceedings.

(2) A written statement, and documentary evidence other than that emanating from a governmental, judicial or administrative authority, shall be signed and sworn to or otherwise solemnized by the maker of the written statement or the documentary evidence before a notary or other authority competent under the law of the place where the authority serves to attest to the authenticity of the written statement or documentary evidence and to its signature and solemnization, and the attestation of the notary or other competent authority shall be affixed or joined to the written statement or documentary evidence. The attestation by a foreign notary or other competent authority shall be acceptable if it is legalized in accordance with the law applicable in [this State] relating to the legalization of foreign public documents.

(3)(a) Documentary evidence emanating from a governmental, judicial or administrative authority outside [this State] shall be acceptable if it is legalized in accordance with the law applicable in [this State] relating to the legalization of foreign public documents.

(b) Documentary evidence emanating from a governmental, judicial or administrative authority in [this State] shall conform to the law applicable in [this State] concerning the signature, solemnization and legalization of such documents.

### Commentary

1. The purpose of this article is to establish international uniformity in the requirements relating to formalities to be complied with respect to written statements and other documentary evidence to be provided by contractors and suppliers. They also seek to remove unnecessary formal obstacles for foreign contractors and suppliers with respect to their provision of required written statements and documentary evidence.

2. With respect to paragraphs (2) and (3), in many States foreign attestations and documents must be legalised through the certification by diplomatic or consular agents of the country from which the document emanated of the capacity of the executor of the document and the authority of its signature and stamp or seal. However, some States are parties to international conventions liberalizing the formalities for authenticating public documents emanating

from other parties to the Convention (e.g., the Convention Abolishing the Requirement of Legalisation for Foreign Public Documents (the Hague, 1961)). Compliance with the provisions of such a Convention would be sufficient under paragraph (2) and (3) in a State that is a party to the Convention.

3. One effect of paragraphs (2) and (3) is that the procuring entity may not reject a foreign attestation or documentary evidence purely on the ground of its foreign source. However, the word "acceptable", rather than, e.g., "accepted", is used in order to make it clear that the foreign attestation or document may be rejected if it does not conform in other respects.

## Chapter II. Tendering proceedings

### Section I. *International tendering proceedings*

#### Article 11. *International tendering proceedings*

(1) Subject to paragraph (2), a procuring entity that is required under article 7 to engage in tendering proceedings may decide to engage in international tendering proceedings, taking into account the objectives of economy and efficiency in the procurement.

(2) Where the price of the procurement contract exceeds the amount set forth in the procurement regulations, a procuring entity that is required under article 7 to engage in tendering proceedings must engage in international tendering proceedings unless it receives approval not to engage in international tendering proceedings. The procuring entity shall not divide its procurement of the goods or construction into separate contracts for the purpose of avoiding the application of this paragraph.

### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, para. 14; A/CN.9/315, para. 122]

1. In many cases, it is in the interest of the procuring entity to promote international participation in tendering proceedings (see paragraph 5 of commentary to article 3). The present article in effect calls upon a procuring entity that is obligated under article 7 to engage in tendering proceedings to determine whether international participation would be advantageous, and thus whether to engage in international tendering proceedings. When it decides to engage in international tendering proceedings the particular procedures specified for those proceedings in chapter II of the model law, which are designed to be conducive to international participation, must be employed.

2. In deciding whether or not to engage in international tendering proceedings the procuring entity must take into account the objectives of economy and efficiency in the procurement. Relevant factors might include, for example, the value of the goods or construction to be procured (e.g., whether the cost and time involved in employing international procedures is disproportionate to the value of the goods or construction), and whether a sufficient degree of competition would exist in the tendering proceedings if

foreign participation were not promoted. The non-availability of the goods or construction from domestic contractors or suppliers might also be relevant.

3. The rationale of paragraph (2) is that, where the price of the procurement contract exceeds a certain value, promoting foreign participation in the tendering proceedings is likely to promote economy and efficiency. There could be cases, however, where the procuring entity concludes that using procedures to promote foreign participation would not promote those objectives; in those cases, the non-use of those procedures must be approved (see paragraph 1 of commentary to article 6).

## Section II. Solicitation of tenders and applications to prequalify

### Article 12. Solicitation of tenders and applications to prequalify

(1) A procuring entity shall solicit tenders, and, where applicable, applications to prequalify, from all interested contractors and suppliers by causing a notice of proposed procurement to be published in . . . [each State enacting this model law specifies the official gazette or other official publication in which the notice of proposed procurement is to be published]. In international tendering proceedings, the notice of proposed procurement shall also be published in a newspaper or relevant trade publication or technical journal of wide international circulation. The publication shall be in a language customarily used in international trade.

(2) Where restricted participation in the tendering proceedings is more conducive to economy and efficiency, the procuring entity may, subject to approval, solicit tenders by sending the notice of proposed procurement only to particular contractors and suppliers selected by it. The procuring entity shall select a sufficient number of contractors and suppliers to ensure effective competition, consistent with the efficient conduct of the tendering proceedings.

#### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 58, 67, 72, 73; 95-99, A/CN.9/315, paras. 31, 45]

1. The model law provides for two types of tendering proceedings: open and restricted. In open tendering proceedings, tenders or applications to prequalify (see article 16) are solicited from all interested contractors and suppliers. In restricted tendering proceedings, tenders are solicited only from particular contractors and suppliers selected by the procuring entity. Prequalification proceedings are not used in restricted tendering proceedings (see paragraph 2 of commentary to article 16).

2. Although participation in restricted tendering proceedings is not open to contractors and suppliers generally, restricted proceedings are not intended to be less competitive than open proceedings. In some cases (e.g., those mentioned later in this paragraph), restricted proceedings can be a more efficient means of procurement

than open tendering proceedings while still providing competition. This article therefore gives the procuring entity the opportunity, subject to approval (see paragraph 1 of the commentary to article 6), to engage in restricted tendering proceedings when those proceedings are more conducive to economy and efficiency in the procurement. Considerations such as the following may be relevant in ascertaining whether, for a particular procurement, restricted tendering proceedings should be used.

(a) The use of open tendering proceedings may result in a large number of tenders that the procuring entity will have to examine, evaluate and compare, and the time and costs of doing so might in some cases be disproportional to the value of the goods or construction to be procured.

(b) In cases where the goods or construction are available only from a few contractors or suppliers, which are known to the procuring entity, it could be more efficient for tenders to be solicited only from those contractors or suppliers through restricted tendering procedures rather than to engage in a general solicitation through open tendering procedures.

(c) Competent contractors and suppliers are sometimes deterred from participating in open tendering proceedings, particularly for the procurement of goods or construction of high value, where the cost of preparing tenders is high and the statistical chance of being the successful tenderer is low due to the potentially large number of tenderers.

3. In some regions, participation in tendering proceedings is sometimes limited to persons or entities that have purchased the procurement documents. Proceedings in which that practice is followed may be regarded as open tendering proceedings if the opportunity to purchase the procurement documents is available to all interested contractors and suppliers. A reason for that practice is to avoid the problems that could arise if a contractor or supplier submitted a tender on the basis of procurement documents that had been incompletely or inaccurately copied by someone without authority to copy the documents. An argument against following that practice, however, is that consulates or other governmental offices of certain countries sometimes obtain and copy procurement documents and distribute them to contractors and suppliers that might be interested in participating in procurement. That can help to promote awareness by contractors and suppliers from those countries of procurement opportunities.

4. Paragraph (1) of this article sets forth the requirements with respect to the solicitation of tenders or applications to prequalify in open tendering proceedings. Its objective is to maximize the potential competitive base through the widespread publicity of a notice of proposed procurement. The publication required by the second sentence of the paragraph is intended to bring the notice of proposed procurement to the attention of foreign contractors and suppliers in the case of international tendering proceedings. One possible medium of such publication is the business edition of *Development Forum*, published by the United Nations Department of Public Information and the United Nations University.



5. The media of publication specified in paragraph (1) are only minimum publicity requirements. Procuring entities may publicize the notice by any additional means that will promote widespread awareness of it by contractors and suppliers. These might include, for example, posting the notice on official notice boards, and circulating it to chambers of commerce, to foreign trade missions in the country of the procuring entity and to trade missions abroad of the country of the procuring entity. The procuring entity might also send the notice to contractors or suppliers on lists of approved contractors or suppliers; however, participation in open tendering proceedings should not be limited to contractors or suppliers on those lists. An implementing State might wish to specify in the procurement regulations the media of publication to be used under paragraph (1).

6. The publication of the notice of proposed procurement is relevant for fixing the deadline for the submission of tenders (see article 24(1)).

7. Paragraph (2) deals with the solicitation of tenders in restricted tendering proceedings. [*Working Group note*: the second sentence is adapted from article V(6) of the GATT Procurement Agreement.]

#### Article 13. *Lists of approved contractors and suppliers*

The procuring entity may use a list of approved contractors and suppliers as its source for the selection of contractors and suppliers from which to solicit tenders pursuant to article 12(2) only if:

(a) requests to be entered on the list are receivable at any time from any interested contractor or supplier and are acted upon within a reasonably short period of time;

(b) entry on the list is subject to no eligibility criterion more stringent than those set forth in article 8(1)(a) and is subject to no qualification criterion more stringent than those established pursuant to article 15;

(c) the existence of the list, the conditions to be satisfied by contractors and suppliers in order to be entered on the list, the methods according to which satisfaction of each of those conditions is to be verified, the period of validity of an entry on the list and the procedures for entry and for renewal of the entry have been generally publicized in a manner designed to bring them to the attention of contractors and suppliers;

(d) the conditions, methods, procedures and other matters referred to in subparagraph (c) do not discriminate against foreign contractors and suppliers with respect to entry on a list used for the solicitation of tenders in international tendering proceedings or with respect to their opportunity to participate in such proceedings; and

(e) the selection by the procuring entity from the list allows all contractors or suppliers on the list equitable opportunities to be selected.

#### *Commentary*

[*Working Group note*: sources: A/CN.9/WG.V/WP.22, para. 94; A/CN.9/315, para. 44. Most of the subparagraphs of this article are adaptations of provisions of the GATT Procurement Agreement: subparagraph (a) is adapted from article V(2)(d) of the GATT Procurement Agreement; subparagraph (c) from article V(7)(a); subparagraph (d) from article V(2)(b) and (c); subparagraph (e) from article V(7)(b).]

1. This article concerns the use of lists of approved contractors and suppliers as the source for the selection of contractors and suppliers to participate in restricted tendering proceedings. Its purpose is to ensure that the procuring entity has a sufficiently broad field from which to make its selection in order to improve its chances of finding the most suitable contractor or supplier for the procurement and to ensure that the use of the list does not inhibit effective competition or unfairly exclude contractors and suppliers. [*Working Group note*: the article has not been made applicable in respect of open tendering proceedings for the following reasons. Participation in those proceedings is open to all interested contractors and suppliers, who must be informed of the opportunity to participate by means of widespread publication of the notice of proposed procurement, and by such additional means as the procuring entity may consider appropriate. Lists of approved contractors or suppliers are sometimes used as one of those additional means (e.g., as a mailing list; see paragraph 5 of commentary to article 12). Since the use of such lists is only one means of soliciting tenders in open tendering proceedings, their use does not present the same risks as does the use of lists in restricted tendering proceedings.]

2. With respect to subparagraph (b), entry on the list need not be subject to all of the same eligibility and qualification criteria that are authorized by articles 8(1)(a) and 15; but it may not be subject to more stringent ones.

3. Under subparagraph (d), in the case of international procurement proceedings, the list could not be used if, for example, the conditions, methods, procedures or other matters precluded foreign contractors or suppliers from entry on the list, or if the entry of foreign contractors or suppliers on the list was subject to undue delays to which domestic contractors or suppliers were not subject, impeding the ability of foreign contractors or suppliers to become entered in time to participate in particular tendering proceedings. However, not all differences between the treatment of foreign contractors or suppliers and the treatment of domestic ones would be impermissible under this provision. For example, delays in entering foreign contractors or suppliers on the list might reflect a greater amount of time reasonably needed to process foreign requests for entry.

#### Article 14. *Contents of notice of proposed procurement*

(1) The notice of proposed procurement shall contain the following information:

(a) the name and address of the procuring entity;

(b) the nature and quantity of the goods to be supplied or the nature and location of the construction to be effected;

(c) the desired or required time for the supply of the goods or for the completion of the construction;

(d) the eligibility criteria set forth in article 8(1)(a);

(e) the means of obtaining the procurement documents and the place from which they may be obtained;

(f) the price, if any, charged by the procuring entity for the procurement documents and, in the case of international tendering proceedings, the currency and means of payment for those documents;

(g) in the case of international tendering proceedings, the language or languages in which the procurement documents are available;

(h) the place and deadline for the submission of tenders.

(2) If prequalification proceedings are to be engaged in, the notice of proposed procurement shall so state. In such a case, the notice of proposed procurement need not contain the information referred to in paragraph (1)(e) or (g), but shall contain the following additional information:

(a) the means of obtaining the prequalification documents and the place from which they may be obtained;

(b) the price, if any, charged by the procuring entity for the prequalification documents and, in the case of international tendering proceedings, the currency and terms of payment for those documents;

(c) in the case of international tendering proceedings, the language or languages in which the prequalification documents are available; and

(d) the place and deadline for the submission of applications to prequalify.

#### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, para. 95; A/CN.9/315, para. 45]

1. Paragraph (1) sets forth basic information that must be included in the notice of proposed procurement in order to enable contractors and suppliers to determine whether they might be sufficiently interested in the proposed procurement to obtain the tender documents and, if so, how to obtain them. The specified information is only the required minimum.

2. Paragraph (2) sets forth additional information that must be included in the notice of proposed procurement if prequalification procedures are to be engaged in (see article 16). In such a case, it is not necessary for the notice to include information concerning the procurement documents, since those documents will be provided to contractors and suppliers that have been prequalified (article 17).

### Section III. Qualifications of contractors and suppliers

#### Article 15. Assessment of qualifications of contractors and suppliers

(1) The procuring entity shall assess the qualifications of contractors and suppliers in accordance with the qualification criteria and procedures set forth in the prequalification documents or in the procurement documents.

(2) The qualification criteria shall be objective to the extent possible and shall be limited to those which are essential to ensure that the contractors or suppliers possess sufficient technical competence, financial resources, equipment and other physical facilities, and sufficient personnel, to perform the procurement contract.

(3) In the case of international tendering proceedings, the procuring entity shall establish no criterion, requirement or procedure with respect to the demonstration or assessment of the qualifications of contractors and suppliers which unduly hinders the ability of foreign contractors and suppliers to show that they are qualified.

#### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 85-89; A/CN.9/315, paras. 40, 41]

1. This article sets forth rules applicable to tendering proceedings, including, where applicable, prequalification proceedings, concerning the qualifications of contractors and suppliers to perform the procurement contract (see article 9). If contractors and suppliers have not been prequalified (see article 16), the procuring entity assesses their qualifications after the opening of tenders. In some cases where contractors and suppliers have been prequalified, their qualifications may be assessed more closely after the opening of tenders. A procuring entity may also conduct post-qualification proceedings to establish that the qualifications of the contractor or supplier submitting the most advantageous tender have not changed.

2. In order to promote transparency, the qualification criteria and the procedures for assessing the qualifications of contractors and suppliers must be set forth in the prequalification documents (article 16(3)(e)) and in the procurement documents (article 18(c)).

3. The aim of paragraphs (1) and (2) is to help ensure that all contractors and suppliers are treated on the same basis and to avoid arbitrariness in the evaluation of qualifications. They also aim to provide a degree of certainty to contractors and suppliers with respect to the prospects of their being found to be qualified. These aims contribute to a procedural climate that is conducive to participation by contractors and suppliers in tendering proceedings. With respect to the requirement that the qualification criteria be objective to the extent possible, the criteria should establish minimum thresholds of acceptability, e.g., that the contractor or supplier shall have supplied goods or performed construction of a similar nature at least once within the past five years.

4. Contractors and suppliers are often called upon to complete a questionnaire eliciting information about various aspects of their qualifications, and to submit other documents (e.g., balance sheets; bank references) to demonstrate their conformity with the qualification criteria. The requirements in that respect must be set forth in the prequalification documents (article 16(3)(d)) or in the procurement documents (article 18(d)) as the case may be. The provisions of article 10, relating to the solemnization and legalization of written statements and documents, apply to such questionnaires and documents. See, also, article 9 and the commentary thereto.

5. With respect to paragraph (3), if, for example, bank references are required but there is no particular necessity for the references to be from banks in the country of the procuring entity, the procuring entity should permit foreign contractors or suppliers to submit references from reputable foreign banks.

#### Article 16. *Prequalification proceedings*

(1) Except where participation in tendering proceedings is restricted pursuant to article 12(2), the procuring entity may engage in prequalification proceedings with a view towards identifying, prior to the submission of tenders, contractors and suppliers that are eligible and qualified to perform the procurement contract.

(2) If the procuring entity engages in prequalification proceedings, it shall provide a set of prequalification documents to each contractor and supplier that requests them in accordance with the procedures specified in the notice of proposed procurement and that pays the price, if any, charged for those documents.

(3) The prequalification documents shall contain all information necessary to enable contractors and suppliers to prepare and submit applications to prequalify, including, but not limited to, the information required to be included in the notice of proposed procurement pursuant to article 14(1), except subparagraph (e) thereof, plus the following information:

(a) instructions for preparing and submitting prequalification applications;

(b) any additional information concerning the goods to be supplied or the construction to be effected that would be useful to contractors or suppliers in preparing their prequalification applications;

(c) a summary of the principal required terms and conditions of the procurement contract to be entered into as a result of the tendering proceedings;

(d) any written statements, documentary evidence or other information that must be submitted by contractors and suppliers to demonstrate their eligibility and qualifications;

(e) the criteria and procedures to be used for assessing the qualifications of contractors and suppliers;

(f) the manner and place for the submission of applications to prequalify and the deadline for the submission, expressed as a specific date and time and allowing sufficient time for contractors and suppliers to prepare and submit their applications, paying

particular regard, in the case of international tendering proceedings, to the time needed by foreign contractors and suppliers;

(g) any other requirements established by the procuring entity in conformity with this Law and the procurement regulations relating to the preparation and submission of applications to prequalify and to the prequalification proceedings;

(h) references to this Law, to the procurement regulations and to all other laws and regulations of [this State] directly pertinent to the prequalification proceedings.

(4) The procuring entity shall promptly notify all contractors and suppliers submitting applications to prequalify whether or not they have been prequalified and shall make available to the general public the names of all contractors and suppliers that have been prequalified. All contractors and suppliers that have been prequalified shall be entitled to submit tenders.

(5) The procuring entity shall upon request communicate to contractors and suppliers that have not been prequalified the grounds therefor, but the procuring entity shall not be required to give reasons to substantiate those grounds.

(6) A procuring entity that has engaged in prequalification proceedings is not precluded from re-assessing at a later stage of the tendering proceedings the eligibility and qualifications of contractors and suppliers that have been prequalified.

#### *Commentary*

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 85 (last 2 sentences), 90-93; A/CN.9/315, paras. 42, 43, 103]

1. This article enables the procuring entity to engage in prequalification proceedings wherever it considers such proceedings useful. The purpose of prequalification proceedings is to eliminate early in the tendering proceedings contractors and suppliers that are not eligible or not suitably qualified to perform the contract and to narrow down the number of tenders that the procuring entity must evaluate and compare. In practice, prequalification proceedings are most often used for procurement of complex or high value goods and construction. The reason for this is that the evaluation and comparison of tenders in those cases is much more complicated, costly and time-consuming than the evaluation and comparison of tenders for less complex or lower value contracts. In addition, competent contractors and suppliers are sometimes reluctant to participate in tendering proceedings for high value contracts, where the cost of preparing the tender may be high, if the competitive field is too large and where they run the risk of having to compete with unrealistic tenders submitted by unqualified or disreputable contractors and suppliers. For less complex or lower value contracts, it is often more efficient to evaluate the qualifications of contractors and suppliers after the opening of tenders than to conduct separate prequalification proceedings.

2. Prequalification proceedings may be engaged in only in connection with open tendering proceedings; they are

unnecessary in restricted tendering proceedings. Indeed, prequalification proceedings should be used only as a method of identifying and eliminating clearly unqualified contractors and suppliers at an early stage, and not as means of restricting participation to particular contractors and suppliers; restricted tendering proceedings are available for the latter purpose.

3. Paragraphs (2) through (5) govern the procedures to be followed in prequalification proceedings. Like the open tendering proceedings with which they are connected, prequalification proceedings are, pursuant to paragraph (2), open to all interested contractors and suppliers that properly request the prequalification documents. Under article 14(2), notice that prequalification proceedings will take place and related information must be included in the notice of proposed procurement for open tendering proceedings, and the notice should thus receive widespread publicity.

4. Paragraph (3) sets forth the information that must be included in the prequalification documents, making it clear that this is only the minimum information to be provided; the documents may also contain further information that would assist contractors and suppliers in preparing and submitting their applications to prequalify. These requirements are analogous to those set forth in article 18 in relation to the information to be provided in the procurement documents. The commentary to that article is thus also relevant in the present context. Article 20 sets forth rules concerning the formulation of the prequalification documents.

5. The assessment of the qualifications of contractors and suppliers in prequalification proceedings is subject to the provisions of article 15.

6. The purpose of paragraph (5) is to promote transparency and to facilitate the exercise by a contractor or supplier that has not been prequalified of its right of redress.

7. With respect to paragraph (6) see paragraph 1 of the commentary to article 15.

#### *Section IV. Procurement documents*

##### *Article 17. Provision of procurement documents to contractors and suppliers*

The procuring entity shall provide a set of the procurement documents to contractors and suppliers in accordance with the procedures and requirements specified in the notice of proposed procurement. If prequalification proceedings have been engaged in, the procuring entity shall provide a set of the procurement documents to each contractor and supplier that has been prequalified and that pays the price, if any, charged for those documents.

#### *Commentary*

[Working Group note: sources: A/CN.9/WG.V/WP.22, para. 100]

This article is self-explanatory. See paragraph 3 of commentary to article 12.

##### *Article 18. Contents of procurement documents*

The procurement documents shall contain all information necessary to enable contractors and suppliers to prepare and submit responsive tenders, including, but not limited to, the following information:

- (a) instructions for preparing tenders;
- (b) the eligibility criteria set forth in article 8(1)(a);
- (c) if the qualifications of contractors and suppliers are to be assessed or re-assessed after the opening of tenders, the criteria and procedures to be used for the assessment or re-assessment;
- (d) any written statements, documentary evidence or other information that must be submitted by contractors and suppliers to demonstrate their eligibility and qualifications;
- (e) the nature and required technical and quality characteristics of the goods or construction to be procured, including, but not limited to, technical specifications, plans, drawings and designs as appropriate; the quantity of the goods; the location where the construction is to be effected; and the desired or required time, if any, when the goods are to be delivered or the construction is to be effected;
- (f) the required terms and conditions of the procurement contract to be entered into as a result of the tendering proceedings;
- (g) whether alternatives to the characteristics of the goods or construction, contractual terms and conditions or other requirements set forth in the procurement documents are solicited;
- (h) if contractors and suppliers are permitted to submit tenders for only a portion of the goods or construction to be procured, a specification of the portion or portions for which tenders may be submitted;
- (i) the manner and, in international tendering proceedings, the currency or currencies in which the tender price is to be formulated and expressed;
- (j) any applicable maximum or minimum tender price, or any applicable range within which tender prices must fall or the formula to be used to establish such range;
- (k) in international tendering proceedings, the language or languages in which tenders are to be prepared;
- (l) any requirements of the procuring entity with respect to the nature, amount and other principal terms and conditions of any tender security to be provided by contractors and suppliers submitting tenders and of any security for the performance of the procurement contract to be provided by the contractor or supplier that enters into the procurement contract, and with respect to the type or types of institutions or entities from which such securities will be acceptable;
- (m) the manner, place and deadline for the submission of tenders;

- (n) the means by which, pursuant to article 24, contractors and suppliers may seek clarifications of the procurement documents and the place and time of any meeting of contractors and suppliers convened by the procuring entity;
- (o) the period of time during which tenders shall be in effect;
- (p) the place, date and time for the opening of tenders, the procedures to be followed for opening, examining, evaluating and comparing tenders and for ascertaining the most advantageous tender, and the criteria to be used for evaluating and comparing tenders and for ascertaining the most advantageous tender, including, but not limited to, such factors as how the criteria will be quantified or otherwise applied, the relative weight or other indication of the degree of importance that each criterion will have, the manner in which the criteria will be combined and in which the tenders will be compared in order to ascertain the most advantageous tender, and any margin of preference that will be applied, its amount and the manner of its application;
- (q) in international tendering proceedings, the currency that will be used for the purpose of evaluating and comparing tenders and either the exchange rate that will be used for the conversion of tenders into that currency or a statement that the rate issued by a specified financial institution prevailing on a specified date will be used;
- (r) any other requirements established by the procuring entity in conformity with this Law and the procurement regulations relating to the preparation and submission of tenders and to the tendering proceedings;
- (s) references to this Law, to the procurement regulations and to all other laws and regulations of [this State] directly pertinent to the tendering proceedings [, and references to tax, social security, safety, environmental protection, health and labour laws and regulations of [this State] pertinent to the performance of the procurement contract];
- (t) the name(s) and address(es) of the person or persons authorized to communicate with contractors and suppliers in connection with the tendering proceedings and to whom communications from contractors and suppliers should be addressed.

#### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 100-106, 123-126; A/CN.9/315, paras. 46-50, 60-66]

1. This article specifies the minimum information that must be included in the procurement documents. Many of those items are regulated or dealt with in other provisions of the model law. The enumeration in this article of all items that are required to be in the procurement documents, and all items the inclusion of which is expressly provided for by the model law, enables procuring entities to use the paragraph as a "check-list" in preparing the procurement documents. The term "responsive tender" used in the *chapeau* to this article is defined in article 28(4).

2. The instructions for preparing tenders referred to in subparagraph (a) should include, among other things, information concerning the form and manner of signature of tenders, and the manner in which the various documents comprising the tender are to be organized (e.g., if the "two-envelope" system is to be used (see paragraph 23 of commentary to article 28)).
3. Subparagraphs (e) and (f) refer to the required characteristics of the goods or construction and the required terms and conditions of the procurement contract. Tenders will have to conform to those characteristics, terms and conditions in order to be regarded as responsive (article 28(4)). Characteristics, terms and conditions that are not required by the procuring entity are matters in respect of which tenderers may make offers in their tenders and which will constitute elements of the competition among tenderers (see article 28(7)(c)(ii) and paragraph 14 of the commentary to article 28).
4. With respect to the required terms and conditions of the anticipated procurement contract, a copy of the conditions of contract that will become part of the procurement contract is often included in the procurement documents. The terms and conditions should, when feasible, refer to internationally recognized trade terms and terminology such as INCOTERMS (see article 20(3)(b) and (c)). Requirements such as an obligation of the contractor or supplier to provide financing should be set forth in the procurement documents.
5. With respect to the formulation of the tender price, (subparagraph (i)), the procurement documents should, for example, specify whether and how contractors and suppliers are to take account of taxes, customs duties and similar charges and levies in formulating the tender price, and the trade terms on which prices are to be based (e.g., ex works, FOB or CIF terms) (see article 20(3)). Such specifications can help ensure that tender prices will be formulated and expressed on a common basis and will therefore be susceptible of uniform comparison.
6. Various approaches are possible with respect to the role of taxes, customs duties and similar charges and levies in formulating the tender price. Under one approach, the procurement documents may require contractors and suppliers to include all such charges and levies in their tender prices, with no right on the part of the contractor or supplier whose tender is accepted to reimbursement from the procuring entity for any charges or levies not included in the tender price. Another approach requires contractors and suppliers to formulate their prices excluding such charges and levies, and permits them to claim reimbursement from the procuring entity for any charges and levies actually paid by them. The latter approach may be more desirable when foreign participation in the tendering proceedings is anticipated or sought. It may be difficult and time-consuming for foreign contractors and suppliers to obtain the information necessary to calculate those charges and levies, particularly with respect to taxes imposed by the country of the procuring entity. In addition, those taxes are sometimes uncertain; for example, procuring entities are sometimes able to obtain tax reductions or other fiscal advantages, particu-

larly where high value contracts or other contracts of special interest to the Government are involved. Thus, different contractors and suppliers may calculate the taxes differently, making it difficult or impossible to make a true comparison of their tender prices. [The contractual terms and conditions included in the procurement documents should clarify which party is to bear the risk of increases in taxes, customs duties or similar charges and levies, or the imposition of new taxes, customs duties or similar charges and levies, to which the contractor or supplier becomes subject in the country of the procuring entity after a specified time (e.g., within 30 days prior to the deadline for the submission of tenders). It might be provided, for example, that the procuring entity is to bear that risk.] [*Working Group note:* the foregoing sentences within square brackets might be included if article 21 is not included.]

7. With respect to trade terms, various approaches are possible. Under one approach the price is to be the total price for delivery to the procuring entity, including, for example, freight and insurance charges. In some cases, however, the procuring entity may wish to provide the transport or insurance (e.g., it may wish to use domestic carriers or insurers in order to promote those domestic industries or to conserve foreign exchange). In such a case, the procuring entity might require contractors and suppliers to base their prices on, for example, FOB terms, or to base their prices on CIF terms but to show separately the FOB price, freight charges to the port of entry in the procuring entity's country, costs of delivery to the procuring entity, and insurance costs. In the latter case, the procuring entity can then decide whether to contract with the successful tenderer on the CIF terms or to contract on the FOB terms and to provide its own transport or insurance.

8. In international tendering proceedings, the procurement documents must specify the currency or currencies in which tender prices are to be expressed. Such currencies might include, for example, the currency of the country of the procuring entity, the currency of the contractor's or supplier's country and a currency customarily used in international trade. Contractors and suppliers might also be permitted to express portions of the tender price in two or more different currencies in which they will incur their expenditures in respect of the goods or construction that they offer to supply. Permitting tender prices to be expressed in currencies other than the currency of the country of the procuring entity can promote economy in procurement when foreign contractors and suppliers participate in the tendering proceedings because they enable those contractors and suppliers to reduce the risk of exchange rate fluctuations to which they would be subject if their tenders were expressed in the currency of the country of the procuring entity. This can enable the contractors and suppliers to offer their most economical prices, without having to include an increment to cover the exchange rate risk. Under that approach, however, the risk of exchange rate fluctuations will be increased for the procuring entity. Moreover, the submission of tenders with tender prices expressed in various currencies will complicate the process of evaluating and comparing tenders, since the tender prices will have to be converted to a

single currency (article 28(8)). As a means of reducing and sharing the risk of exchange rate fluctuations and reducing the other disadvantages that can accrue when tender prices are expressed in several currencies contractors and suppliers might be called upon to express their tender prices in a relatively stable unit of account, such as the Special Drawing Right (SDR) of the International Monetary Fund.

9. In practice, procuring entities sometimes require contractors and suppliers to disclose the components and calculations of their tender prices, including the way in which profit is factored into the prices. This sometimes enables procuring entities to ascertain whether the tender prices are realistic or fair. However, contractors and suppliers often regard such information as confidential and imposing such requirements could dissuade some contractors or suppliers from participating in tendering proceedings.

10. With respect to subparagraph (p), the opening of tenders must take place at the time set forth in the procurement documents as the deadline for the submission of tenders (article 27(1)).

11. With a view towards promotion of transparency, subparagraph (s) requires that the procurement documents alert contractors and suppliers to the model law, the procurement regulations and all other laws and regulations of the implementing State directly pertinent to the tendering proceedings. Those other laws and regulations, in particular, might not otherwise ordinarily come to the attention of foreign contractors and suppliers. They might include, for example, laws and regulations relating to stamps required to be affixed to a tender, or requiring a copy of a tender to be submitted to a particular office. [In addition, the procurement documents must set forth references to the other specified types of laws and regulations pertinent to the performance of the procurement contract.] [*Working Group:* that provision and the preceding sentence have been placed within square brackets to invite the Working Group to consider whether such references should also be required.]

12. The requirement in subparagraph (t) is intended to avoid questions or misunderstandings with respect to the proper addressee of communications to the procuring entity and the authority of employees of the procuring entity to communicate with contractors and suppliers. The authorized person might, for example, be the chief procurement officer of the procuring entity.

13. In addition to the information required by this article, it would be desirable for the procurement documents to include a form of tender on which contractors and suppliers are to set forth their tender prices and other basic elements of their tenders and which they are to sign. Providing such a form could contribute to uniformity of presentation and efficiency in the examination, evaluation and comparison of tenders. It would also be desirable for the procurement documents to include forms of any required securities so as to help ensure that the securities submitted by contractors and suppliers will conform to the procuring entity's requirements. See, also, paragraph 4 of the commentary to article 26.

### Article 19. *Charge for procurement documents*

The procuring entity may charge contractors and suppliers a sum for procurement documents provided to them. The sum shall reflect only the cost of printing the procurement documents and providing them to contractors and suppliers.

#### *Commentary*

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 107-109; A/CN.9/315, para. 51]

The aim of this article is to enable the procuring entity to recover its costs of printing and providing the procurement documents, but to avoid excessively high charges that could inhibit qualified contractors and suppliers from participating in the tendering proceedings.

### Article 20. *Rules concerning formulation of prequalification documents and procurement documents*

(1) Specifications, plans, drawings and designs setting forth the technical or quality characteristics of the goods or construction to be procured, and requirements concerning testing and test methods, packaging, marking or labelling or conformity certification, and symbols and terminology, shall not be included or used in the prequalification documents or in the procurement documents with a view to creating obstacles to participation by contractors or suppliers in tendering proceedings including, in the case of international procurement proceedings, foreign contractors and suppliers, nor shall such specifications, plans, drawings, designs, requirements, symbols or terminology be included or used which have the effect of creating unnecessary obstacles to such participation.

(2) To the extent possible, specifications, plans, drawings, designs and requirements shall be based on the relevant objective technical and quality characteristics of the goods or construction to be procured. There shall be no requirement of or reference to a particular trade mark, name, patent, design, type, specific origin or producer unless there is no other sufficiently precise or intelligible way of describing the characteristics of the goods or construction to be procured and provided that words such as "or equivalent" are included.

(3)(a) Standardized features, requirements, symbols and terminology relating to the technical and quality characteristics of the goods or construction to be procured shall be used, where available, in formulating the specifications, plans, drawings and designs to be included in the prequalification documents and in the procurement documents.

(b) Standardized trade terms shall be used, where available, in formulating the terms and conditions of the procurement contract to be entered into as a result of the procurement proceedings and in formulating other relevant aspects of the prequalification documents and of the procurement documents.

(c) In the case of international procurement proceedings, internationally standardized features, requirements, symbols, terminology and trade terms

shall be used, where available; if they are not available, nationally standardized features, requirements, symbols, terminology and trade terms shall be used, where available.

(4) In the case of international procurement proceedings, the prequalification documents and the procurement documents shall be formulated in . . . [each State enacting this model law specifies its official language or languages] [and in a language customarily used in international trade]. [In the event of a variation or conflict between language versions, the version in the language customarily used in international trade shall prevail.]

#### *Commentary*

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 110-114; A/CN.9/315, paras. 52-55]

[Paragraph (1) is based on article IV(1) of the GATT Procurement Agreement; paragraph (2) is based on article IV(3) of the GATT Procurement Agreement.]

1. To the extent possible, the prequalification documents and the procurement documents should be formulated in a clear, complete and objective manner, particularly with respect to the description of the goods or construction to be procured. Procurement documents with those characteristics enable tenderers to formulate tenders that meet the needs of the procuring entity, and to forecast the risks and costs of their participation in the tendering proceedings and of the performance of the contract to be concluded, and thus to offer their most advantageous prices and other terms and conditions. They enable tenders to be evaluated and compared on a common basis, which is one of the essential requirements of the tendering method. They also contribute to transparency and reduce possibilities of erroneous, arbitrary or abusive actions or decisions by the procuring entity. The present article is intended to promote those objectives.

2. With respect to paragraph (3), see paragraphs 4 and 7 of the commentary to article 18. Paragraph (4) is intended to help make the procurement documents understandable to foreign contractors and suppliers. The reference to a language customarily used in international trade and the final sentence within square brackets need not be adopted by an implementing State whose official language is one customarily used in international trade.

[Article 21. *New or amended laws or regulations relating to taxes, customs duties or similar charges, or affecting performance of procurement contract*]

[The procurement contract shall provide for the procuring entity to bear any extra costs incurred by the contractor or supplier that becomes a party to the procurement contract due to new or changes in laws or regulations of [this State] relating to taxes, customs duties or similar charges, or affecting the performance by the contractor or supplier of the procurement contract, that come into force after the date [30] days prior to the deadline for submission of tenders.]

*[Commentary]*

[1. The reason for this provision is that, in formulating their tenders, contractors and suppliers will assess their costs and compute their tender prices on the extent of their obligations under laws and regulations in existence at the time they prepare their tenders. Any increases in costs to the contractor or supplier due to subsequent changes in the laws and regulations referred to should be borne by the procuring entity. The [30] day time period is chosen because changes occurring after that date may not come to the attention of contractors and suppliers in time to make any necessary alterations to their tenders prior to the deadline for submitting tenders.]

[2. Where contractors and suppliers are to exclude taxes from the formulation of their tender prices and may claim reimbursement from the procuring entity for taxes actually paid (see paragraph 6 of commentary to article 18), a contractor or supplier would not incur any extra costs as a result of new taxes or changes in tax laws, and the contractual provision required by the present article would not be applicable in such a case.]

*[Working Group note: this article and commentary have been placed within square brackets to invite the Working Group to consider whether or not such an article should be included. In principle, the model law deals only with the procedures for procurement and not matters relating to the substance of the contract (see A/CN.9/315, para. 14). However, some experts in procurement consulted by the Secretariat have suggested that such a provision would be useful.]*

#### Article 22. *Clarifications and modifications of procurement documents*

(1) A contractor or supplier requiring a clarification of the procurement documents shall communicate a request for such clarification to the procuring entity. The procuring entity shall respond promptly to any request for clarification that is received by it prior to the deadline for submission of tenders. Copies of the response by the procuring entity, which shall not identify the source of the request, shall be communicated to all contractors and suppliers to which the procuring entity provides the procurement documents.

(2) At any time prior to the deadline for submission of tenders, the procuring entity may, for any reason, whether at its own initiative or in response to a clarification requested by a contractor or supplier, modify the procurement documents by issuing an addendum thereto. The addendum shall be communicated promptly to all contractors and suppliers to which the procuring entity sends the procurement documents and shall be binding on them.

(3) Any request for clarification and any response thereto by the procuring entity and any addendum to the procurement documents shall be made in writing or in any other form that preserves a record of the request, response or addendum.

(4) If the procuring entity convenes a meeting of contractors and suppliers, it shall prepare minutes of the meeting containing the requests submitted at the meet-

ing for clarification of the procurement documents, without identifying the sources of the requests, and its responses to those requests. The minutes shall be prepared in writing or in any other form that provides a record of the information contained therein and shall be communicated to all contractors and suppliers to which the procuring entity provides the procurement documents.

*Commentary*

*[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 115-119; A/CN.9/315, paras. 56-58]*

1. Any clarification and modification of the procurement documents should be issued and communicated in time to enable contractors and suppliers to take appropriate action, such as modifying or withdrawing their tenders. Under article 25(3), tenders may be modified or withdrawn only prior to the deadline for the submission of tenders. If a clarification or modification of the procurement documents is issued or communicated at a time too close to the deadline, the procuring entity may have to extend the deadline in order to enable contractors and suppliers to take appropriate action (see article 24(2)). In such a case, the time of opening tenders will have to be extended (see article 27(1)) and the procuring entity will have to request contractors and suppliers to extend the period of effectiveness of their tenders and of their tender securities (see article 25(2)). In addition, in some cases, the time for the performance of the procurement contract may have to be extended.

2. With respect to paragraph (4), a meeting of contractors and suppliers may be a useful and efficient manner of dealing with requests for clarifications of the procurement documents in cases where the procurement documents are lengthy and complex and the value of the goods or construction is high. The procurement regulations might set forth rules concerning such meeting, for example, requiring all requests for clarifications to be submitted in writing.

### Section V. *Tenders*

#### Article 23. *Language of tenders*

Tenders shall be formulated and submitted in ... [each State enacting this model law specifies its official language or languages]. In international tendering proceedings, at the option of the contractor or supplier, tenders may be formulated and submitted in any language in which the procurement documents have been issued.

*Commentary*

*[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 121, 122; A/CN.9/315, para. 59]*

See article 20(4), dealing with the language of the procurement documents.

#### Article 24. *Submission of tenders*

(1) The procuring entity shall fix a specific date and time as the deadline for the submission of tenders. The



deadline shall allow sufficient time for contractors and suppliers to prepare and submit their tenders, paying particular regard, in the case of international tendering proceedings, to the time needed by foreign contractors and suppliers.

(2)(a) The procuring entity may, prior to the deadline for submission of tenders, extend the deadline:

(i) in order to afford contractors and suppliers reasonable time to take into account in their tenders a response by the procuring entity to a request for clarification of the procurement documents or a modification of those documents, or

(ii) if, due to unforeseen circumstances, it is not possible for contractors or suppliers to submit their tenders by the deadline.

(b) Notice of any extension of the deadline shall be given promptly in writing or in any other form that provides a record of the information contained therein to each contractor and supplier to which the procuring entity provides the procurement documents.

(3) A tender received by the procuring entity after the deadline for the submission of tenders shall not be opened or considered and shall be returned to the contractor or supplier that submitted it. [However, a tender submitted after the deadline may be considered if the contractor or supplier was not able to submit its tender by the deadline due to reasons beyond its control.]

(4) Tenders shall be submitted in writing and in sealed envelopes. [However, the procuring entity may give contractors and suppliers the option to submit tenders by any other means that provides a record of the information contained in the tender.] The procuring entity shall provide to the contractor or supplier a receipt showing the date and time when the tender was received.

#### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 127-134; A/CN.9/315, paras. 67-69]

1. The procuring entity is to fix the deadline by which tenders must be submitted. In fixing the deadline, the procuring entity should take into account such factors as the complexity of the goods or construction to be procured, the extent of subcontracting anticipated and the time needed for transmitting tenders, particularly, in the case of international tendering proceedings, from foreign points. An implementing State may wish to establish in the procurement regulations minimum periods of time that the procuring entity must allow for the submission of tenders.

2. Paragraph (2) permits the procuring entity to extend the deadline in certain circumstances. The deadline should be extended only in exceptional cases, since frequent extensions could result in inefficiency in the tendering proceedings and could facilitate abuse (e.g., by enabling the procuring entity to favour a particular late contractor or supplier).

3. The policy underlying paragraph (3) is that considering a late tender would be unfair to other contractors and suppliers. It could also interfere with order and efficiency in the tendering proceedings. [However, the procuring entity is permitted to consider a tender that was submitted late due to circumstances beyond the control of the contractor or supplier.] [Working Group note: that sentence and the provision of paragraph (3) to which it refers have been placed within square brackets to invite the Working Group to consider whether or not such a provision should be included]. To be timely, a tender must be received by the procuring entity prior to the deadline for submission of tenders. Thus, the risk of non-delivery or mis-delivery is upon the contractor or supplier.

[4. With respect to the second sentence of paragraph (4), the procuring entity may wish in some cases to enable contractors and suppliers to submit tenders by means other than writing. Tenders submitted by such means must contain all information and documentation required by the procurement documents. Thus, submission by such means would be practicable only in the case of simple tenders where price and a minimum of other factors (e.g., the delivery date) are the only aspects in respect of which tenders are solicited and that require a minimum of supporting information and documentation. In such cases, the procurement documents might, for example, call upon contractors and suppliers to communicate to the procuring entity their tender prices and their offers concerning any other factors in respect of which tenders are solicited, together with a statement that by submitting a tender the contractor or supplier is deemed to have agreed to all the terms, conditions and provisions set forth in the procurement documents. [Working Group note: this paragraph and the sentence to which it refers have been placed within square brackets in order to invite the Working Group to consider whether or not such a provision should be included. Enabling tenders to be submitted by means other than in writing and in sealed envelopes (e.g., by telex or facsimile) could promote speed and efficiency; however, such means do not provide the confidentiality of tenders that is provided by submission of tenders in sealed envelopes.]

5. The manner, place and deadline for the submission of tenders must be set forth in the procurement documents (article 18(m)).

#### Article 25. *Period of effectiveness of tenders; modification and withdrawal of tenders*

(1) Tenders shall be in effect during the period of time specified in the procurement documents. The period of time shall commence at the deadline for submission of tenders.

(2)(a) Prior to the expiry of the period of effectiveness of tenders, the procuring entity may request contractors or suppliers to extend the period for an additional specified period of time. A contractor or supplier may refuse the request without forfeiting its tender security. The request and the responses thereto shall be made in writing or by any other means that provides a record of the information contained therein.

(b) The procuring entity may require contractors and suppliers that agree to the extension to extend or to procure an extension of the period of effectiveness of tender securities provided by them or, if it is not possible to do so, to provide new tender securities, to cover the extended period of effectiveness of their tenders.

(3) A contractor or supplier may modify or withdraw its tender prior to the deadline for the submission of tenders by communicating the modification or a notice of withdrawal to the procuring entity in writing or in any other form that provides a record of the information contained therein. The modification or notice of withdrawal is effective if it is received by the procuring entity prior to the deadline for submission of tenders.

#### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 138-143; A/CN.9/315, paras. 76-78]

1. The procuring entity will normally want tenders to remain in force and effect for a period of time beyond the deadline for the submission of tenders. This is because it usually takes some time after the opening of tenders for them to be processed and for the contract to enter into existence. The procuring entity will want to be assured that, after completion of those procedures, a procurement contract will enter into existence in accordance with the terms and conditions of the tender that has been accepted. In addition, the procuring entity will want to be sure that if, for some reason, the procurement contract does not enter into existence, or if the contractor or supplier whose tender is accepted fails to supply a required security for the performance of the contract, other tenders will remain in force and effect and capable of being accepted.

2. Under paragraph (1), the procuring entity is to fix the length of the period of effectiveness of tenders. The period must be set forth in the procurement documents (article 18(o)). The period should be long enough to cover the amount of time it should realistically take to open, evaluate and compare the tenders, obtain all necessary approvals (which may include the approval of a lending institution), for the procurement contract to enter into force and for the tenderer to supply a security for the performance of the contract, if required. However, the period of effectiveness should not be excessively long; otherwise, higher tender prices may result since contractors and suppliers will have to include in their prices an increment to compensate for the costs and risks to which they would be exposed during such a period (e.g., the risks of higher manufacturing or construction costs; the necessity for contractors and suppliers to keep their resources committed to the project for the long period of time; the costs of the tender security covering the long period of time).

3. Paragraph (2)(a) permits the procuring entity to request an extension of the period, for example, in cases where the tendering proceedings cannot be concluded and the contract cannot be entered into within the specified period of time. Extensions of the period should be avoided, since they could result in the loss of advantageous tenders and could interfere with the effi-

cient functioning of the tendering proceedings. To avoid the necessity of extending the period the procuring entity should endeavour to fix in the procurement documents a period of time of as realistic a length as possible. With respect to paragraph (2)(b), see paragraph 9 of the commentary to article 26.

4. With respect to paragraph (3), the ability to modify tenders by means other than in writing (e.g., by telex or facsimile) enables contractors and suppliers to make last-minute adjustments to their tender prices.

### Section VI. Tender securities

#### Article 26. Tender securities

(1) If the procuring entity requires contractors and suppliers submitting tenders to provide a tender security:

(a) the requirement shall apply to all such contractors and suppliers;

[(b) in international tendering proceedings, a contractor or supplier shall not be precluded from providing a tender security issued by a foreign institution or entity of the type or a type, if any, specified in the procurement documents, unless the issuance of the security would otherwise be in violation of the law of [this State]].

(2) The procuring entity shall make no claim to the amount of the tender security, and shall, without delay, return or procure the return of the tender security to the contractor or supplier that supplied it, after the earliest to occur of:

(a) the expiry of the tender security,

(b) the entry into force of a procurement contract and the provision of a security for the performance of the contract, if such a security is required, or

(c) the rejection by the procuring entity of all tenders pursuant to article 28(2) or (3) or article 29.

#### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 144-154; A/CN.9/315, paras. 79-84. Pursuant to A/CN.9/315, para. 79, the Secretariat proposes to refer generically to the instrument provided by a contractor or supplier to secure its obligations in the tendering proceedings as a "tender security". An effort has been made to set forth in this article minimal rules to regulate matters that are particular to tender securities. The principal reason for this is that the legal system of the implementing State is likely already to contain rules governing securities in general, which it would be unnecessary and even dangerous to duplicate in the model law. The Working Group will recall that, at the twenty-second session of the Commission (1989), it was decided to undertake the preparation of a uniform law on independent guarantees and stand-by letters of credit. It might be expected that various issues addressed in that project will be of relevance to tender securities.]

1. The term "tender security" is defined in article 2(f). The basic purpose of a tender security is to provide funds to cover at least a portion of the losses that a procuring entity would suffer if the tender was withdrawn prematurely or if for other reasons (see paragraph 7 of the present commentary) a procurement contract with the contractor or supplier whose tender had been accepted did not enter into force. Those losses could include, for example, the costs of having to engage in new procurement proceedings, the difference between the tender price of the defaulting contractor or supplier and a higher price that the procuring entity ultimately must pay, and losses due to delays in procurement. Other possible purposes of requiring a tender security are to discourage the contractor or supplier from committing one of the above-mentioned defaults. It should be noted, however, that under certain types of tender securities the procuring entity may be able to claim the amount of the security without having to prove a default by the contractor or supplier and without having to prove loss.

2. It is for the procuring entity to decide whether or not to require a tender security in particular tendering proceedings. A requirement that a tender security be provided must be set forth in the procurement documents (article 18(1)). Tender securities are usually important when the procurement is of high-value goods or construction. In the procurement of low-value items, the risks faced by the procuring entity and its potential losses are generally low, and the cost of providing a tender security—which will normally be reflected in the contract price—will be less justified. Since the cost of providing a tender security may be reflected in the tender prices, it would be desirable for procuring entities to require securities only when needed to protect their interests.

3. Under paragraph (1)(a) the procuring entity may require a tender security only of all contractors and suppliers. It may not require a tender security from some contractors and suppliers and exempt others from the requirement.

4. Any requirements of the procuring entity with respect to the nature and amount and other principal terms and conditions of the tender security and with respect to the type or types of institutions from which tender securities will be acceptable must be set forth in the procurement documents (article 18(1)). It may be desirable for the procurement documents to include a form of a required tender security (see paragraph 13 of commentary to article 18). If a form is included, all terms and conditions contained in the form would become requirements to which tender securities provided by contractors and suppliers would have to conform. If a tender security did not conform to the requirements set forth in the procurement documents, the tender would have to be rejected as non-responsive (article 28(2)(c)).

5. With respect to the nature of the security, a guarantee is often required by procuring entities. Other possible types of security include a bond, irrevocable letter of credit, cheque and cash deposit with a financial institution as stake-holder. The procuring entity may require a particular type of security from a particular type of institution

(e.g., a guarantee or a bond from a bank, surety company or other financial institution), or it may specify two or more types of securities or institutions which would be acceptable, giving contractors and suppliers the option to choose which to provide.

6. It is desirable that the required amount of the tender security be high enough to give the procuring entity a reasonable level of protection, but not so high that the cost of obtaining it dissuades qualified tenderers from participating in the tendering proceedings. It may be desirable in some cases for the required amount of the tender security to be expressed as a specified sum of money, rather than as a percentage of the tender price. The percentage approach could enable a tenderer to ascertain the tender prices offered by other tenderers if it were able to discover the amounts of the tender securities supplied by them.

7. Among the required terms and conditions of the tender security set forth in procurement documents should be the conditions under which the procuring entity is entitled to the amount of the security. For example, the procurement documents might require the tender security to provide that the procuring entity is entitled to claim the amount of the security if the contractor or supplier withdraws or modifies its tender contrary to the provisions of article 25, if the contractor or supplier does not accept a correction by the procuring entity of an arithmetical error in its tender (see article 28(1)(b) and (2)(b)), or if the tender submitted by the contractor or supplier has been accepted by the procuring entity but the contractor or supplier fails to sign a procurement contract if required to do so (see article 32(3)) or fails to provide a required security for the performance of the procurement contract. With respect to the latter condition, it might be specified that the procuring entity may not claim the amount of the tender security if the written procurement contract that the contractor or supplier fails to sign does not conform to its tender. When a security in the form of a tender guarantee is required, the procurement documents should clearly indicate whether the guarantor is obligated to pay the amount of the guarantee if an event mentioned in the guarantee in fact occurs, or merely upon presentation of a document by the procuring entity stating that the event has occurred.

[8. Paragraph (1)(b) is intended to avoid unnecessary obstacles to participation in international procurement proceedings by some foreign contractors or suppliers that could arise if they were restricted to providing securities issued by institutions in the implementing State.]

[Working Group note: the preceding paragraph and the provision to which it refers have been placed within square brackets to invite the Working Group to consider whether such a provision should be included. An argument in favour of including such a provision is stated in the preceding paragraph. An argument against including such a provision, and in favour of enabling the procuring entity to require the tender security to be issued by a local institution, is that, if the procuring entity considers itself to be more secure with a security from local institution (e.g., if it considers it easier to enforce a claim to the guarantee amount against a local institution than against a

foreign one), it should be able to impose such a requirement; any higher cost to a foreign contractor or supplier from providing a tender security issued by a local institution or obtaining a counter guarantee would be reflected in the tender price which, if the tender was accepted, would be passed on to the procuring entity. Subparagraph (b) seeks to reconcile the policy of avoiding obstacles to participation by foreign contractors and suppliers with the above-mentioned interest of procuring entities.]

9. The procurement documents should specify the period of time during which the tender securities to be provided by contractors and suppliers must be in effect. It is generally desirable to require tender securities to be in effect for the entire period of time during which tenders must remain in effect (see article 25), plus an additional period of time to enable the procuring entity to take action to claim the amount of the security if necessary. If a tender security were to remain in effect only until, for example, the deadline for submission of tenders, or until a tender had been accepted, and the contractor or supplier whose tender had been accepted failed to sign a procurement contract or to supply a security for performance, the procuring entity could find that the tender security had expired, leaving the procuring entity without protection.

10. Paragraph (2) is intended to protect the rights of the contractor or supplier in respect of a tender security provided by it. If the procuring entity violates this provision by making a claim under the tender security after any of the indicated events occur he will incur liability under applicable legal rules to the contractor or supplier that supplied the security. The time when a procurement contract enters into force is specified in article 32(2) and (3)(b). The requirement that the security be returned is of particular importance in the case of a security in the form of a deposit of cash or other transferable medium of value.

## Section VII. Opening, examination, evaluation and comparison of tenders

### Article 27. Opening of tenders

(1) Tenders shall be opened at the time set forth in the procurement documents as the deadline for the submission of tenders or an extension thereof, at the place and in accordance with the procedures specified in the procurement documents.

(2) All contractors and suppliers that have submitted tenders or their representatives shall be permitted to be present at the opening of tenders.

(3) The name and address of each contractor or supplier whose tender is opened and the tender price shall be announced to those persons present at the opening of tenders.

### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 157-160; A/CN.9/315, paras. 85-87]

1. Permitting contractors and suppliers or their representatives to be present at the opening of tenders contributes

to transparency of the tendering proceedings. It enables tenderers to observe that the procurement laws and regulations are being complied with and helps to promote confidence that decisions will not be taken on an arbitrary or improper basis.

2. For the procurement of simple goods or construction, where the examination, evaluation and comparison of tenders is routine (e.g., where the only variable in tenders is the tender price and where the procuring entity must accept the tender of the eligible and qualified contractor or supplier offering the lowest price (see article 28(7)(c)(i)), the opening of tenders might be conducted by an official of the procuring entity, such as the chief procurement officer. In cases where the examination, evaluation and comparison of tenders is complex (e.g., where the most economically advantageous tender must be ascertained; see article 28(7)(c)(ii)), the implementing State might consider it desirable for the opening of tenders to be conducted by a committee, composed of representatives of the procuring entity and of various relevant ministries, departments or other governmental organs (e.g., ministries of trade and of finance, the central bank and the financial controller). The implementing State could provide for such a committee by regulation.

3. The procurement documents must set forth the place, date, time and procedures to be followed for the opening of tenders (article 18(p)).

### Article 28. Examination, evaluation and comparison of tenders

(1)(a) To assist in the examination, evaluation and comparison of tenders, the procuring entity may ask contractors and suppliers for clarifications of their tenders. Any request for clarification and any response to such a request shall be in writing or in any other form that provides a record of the information contained therein. No change in the tender price or other matter of substance in the tender shall be sought, offered or permitted, except as provided in subparagraph (b).

(b) The procuring entity shall correct purely arithmetical errors discovered in a tender. Any such correction shall be binding on the contractor or supplier that submitted the tender if accepted by that contractor or supplier.

(2) The procuring entity shall reject a tender:

(a) if the contractor or supplier that submitted the tender is not eligible [, subject to article 8(4),] or is not qualified to perform the procurement contract;

(b) if the contractor or supplier submitted the tender does not accept a correction of an arithmetical error made pursuant to paragraph (1)(b);

(c) if the tender is not responsive, except as provided in paragraph (6) of this article and in article 29(1)(a).

(3) Subject to approval, the procuring entity may reject a tender if the contractor or supplier that submitted it attempts improperly to influence the procuring entity in the process of examining, evaluating or com-

paring tenders or ascertaining the most advantageous tender.

(4)(a) A tender is responsive if it conforms to the required characteristics of the goods or construction to be procured, contractual terms and conditions and other requirements set forth in the procurement documents. However, the procuring entity may regard a tender as responsive if it contains only minor deviations that do not materially alter or depart from those characteristics, terms, conditions and other requirements. Those permitted deviations shall be quantified and appropriately taken account of in the evaluation and comparison of tenders.

(b) Alterations of or departures from required characteristics, terms, conditions and other requirements of the procurement documents are material if they concern, among other things, the nature and technical and quality characteristics of the goods or construction; the quantity of the goods; the location where the construction is to be effected; the time when the construction is to be completed; the place or time when the goods are to be delivered; the terms of the procurement contract relating to the price or payment thereof; the extent of liability of one party to the other; the settlement of disputes; the tender security; the security for performance of the procurement contract; or the quality guarantee in respect of the goods or construction.

[(5) If the procurement documents solicit tenders for alternatives to the characteristics of the goods or construction, contractual terms and conditions or other requirements set forth in the procurement documents, the procuring entity shall evaluate and compare such alternative tenders together with the tenders based on the characteristics, contractual terms and conditions and other requirements set forth in the procurement documents in order to ascertain the most advantageous tender.]

(6) [Alternative 1]

[A contractor or supplier wishing to submit an unsolicited tender for an alternative to the technical characteristics of the goods or construction set forth in the procurement documents must also submit a tender conforming to the technical characteristics set forth in the procurement documents. An alternative tender may be considered by the procuring entity only if it was submitted by the contractor or supplier whose tender based on the technical characteristics set forth in the procurement documents has been found to be the most advantageous of such tenders.]

[Alternative 2]

[The procuring entity may consider an unsolicited tender for an alternative to the technical characteristics of the goods or construction set forth in the procurement documents if a reasonable opportunity is provided to all eligible and qualified contractors and suppliers that have submitted tenders conforming to the technical characteristics set forth in the procurement documents to alter their tenders or to submit additional tenders

based on the alternative tender. The procuring entity shall evaluate and compare the alternative, altered and additional tenders together with the unaltered tenders in order to ascertain the most advantageous tender.]

(7)(a) The procuring entity shall evaluate and compare tenders that have not been rejected pursuant to paragraph (2) or (3) in order to ascertain the most advantageous tender in accordance with the procedures and criteria set forth in the procurement documents.

(b) The evaluation and comparison of tenders shall be carried out in an objective manner.

(c) The most advantageous tender shall be either:

(i) the tender with the lowest tender price, subject to any margin of preference applied pursuant to subparagraph (e) of this paragraph, or

(ii) the most economically advantageous tender, which shall be ascertained on the basis of objective and quantifiable criteria, to the extent possible, including, in addition to the tender price, subject to any margin of preference applied pursuant to subparagraph (e) of this paragraph, such criteria as: the costs of operating, maintaining and repairing the goods or construction over its expected useful life; the functional characteristics of the goods or construction; the efficiency and productivity of the goods or construction; the time for delivery of the goods or completion of the construction; the terms of payment; and the terms and conditions of the quality guarantee in respect of the goods or construction; in so far as such criteria are not the subjects of required characteristics of the goods or construction or required contractual terms or conditions set forth in the procurement documents.

[(d) In addition to criteria of the nature referred to in subparagraph (c)(ii) of this paragraph, the procuring entity may apply criteria directed to ascertaining the impact of tenders in relation to specific Government programmes or policies for the promotion of national economic development, economic development of particular regions within [this State] or development of particular industries or economic sectors. To the extent possible, such criteria shall be expressed in the procurement documents in objective and quantifiable terms.]

(e) In evaluating and comparing tenders, a procuring entity may grant a margin of preference for the benefit of tenders for construction by domestic contractors and suppliers or for the benefit of tenders for domestically produced goods. The margin of preference shall be applied by adding to the tender prices of all tenders other than those that are to benefit from the margin of preference the amount provided for in the procurement regulations.

(8) When tender prices are expressed in two or more currencies, the tender prices shall be converted to a single currency for the purpose of evaluating and comparing tenders.

(9) Information relating to the examination, clarification, evaluation and comparison of tenders shall not be disclosed to contractors or suppliers or to any other

person not officially involved in the examination, evaluation or comparison of tenders or in the decision of which tender should be accepted, except as provided in article 33(2).

[(10) The ascertainment by the procuring entity of the most advantageous tender is subject to approval.]

### Commentary

#### Paragraphs (1) to (4)

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 137, 162-168; A/CN.9/315, paras. 75, 88, 89]

1. With respect to paragraph (1)(b), if the contractor or supplier does not accept the correction its tender must be rejected (paragraph (2)(b)).

[2. The reference in paragraph (2)(a) to article 8(3) is a reminder that a contractor or supplier that is ineligible or cannot establish its eligibility can, under certain conditions, participate in the tendering proceedings.]

[Working Group note: the reference in the text to article 8(3) and the foregoing paragraph of the commentary have been placed within square brackets due to the differing views reflected in A/CN.9/315, para. 39.]

3. Pursuant to paragraph (2)(c), responsiveness is defined in paragraph (4). Paragraph (4) permits, but does not require, the procuring entity to regard a tender as responsive if it contains only minor, nonmaterial deviations. Paragraph (4)(b) elaborates upon the concept of "material" deviation. [Working Group note: as suggested in A/CN.9/315, para. 89, paragraph (4)(b) is adapted from article 19 of the United Nations Sales Convention.]

4. Paragraph (4)(a) requires the procuring entity to quantify permitted minor deviations and to take them into account in the evaluation and comparison of tenders. If the most advantageous tender is to be that with the lowest tender price (paragraph (7)(c)(i)), the deviations should be quantified in monetary terms and added to or subtracted from the tender price, as appropriate. If the most advantageous tender is to be the tender found to be the most economically advantageous (paragraph (7)(c)(ii)), the quantification should be incorporated appropriately in the calculations engaged in to ascertain that tender.

5. A procuring entity may in some cases wish to establish a maximum or minimum price, or a range of prices within which tender prices must fall (e.g., 10% above and below the average (e.g., mean or median) of tender prices of tenders submitted by eligible and qualified contractors and suppliers). Any such requirement must be set forth in the procurement documents (article 18(j)). A tender with a price that exceeds the maximum price, that is lower than the minimum price or that falls outside the range of prices is non-responsive and, except as provided in article 30(1)(a), must be rejected.

6. A reason for establishing a maximum price may be to set a limit to the amount that the procuring entity will pay for the goods or construction. This limit sometimes reflects a maximum budgetary appropriation for the procurement. A reason for establishing a minimum price is

that a contractor or supplier may be unlikely to be able to perform the contract at a price below that amount, or could do so only by using substandard workmanship or materials or by suffering a loss. An abnormally low price could also in some cases indicate collusion between tenderers. A range of tender prices may be based on the notion that the range constitutes a zone of reasonable prices for the goods or construction to be procured.

7. For the procurement of goods or construction that are separable into two or more distinct elements (e.g., the procurement of different types of laboratory apparatus; the procurement of a hydroelectric plant consisting of the construction of a dam and the supply of a generator), a procuring entity may in some cases wish to permit contractors and suppliers to submit tenders either for the entirety of the goods or construction or for one or more portions thereof. That approach might enable the procuring entity to maximize economy by procuring either from a single contractor or supplier or from a combination of them, depending on which approach the tenders revealed to be more cost effective. Permitting partial tenders may also have the advantage of encouraging participation by large contractors and suppliers that prefer to tender for higher value contracts, and that would be attracted by the ability to tender for the entirety of the goods or construction, as well as by smaller contractors and suppliers, that may have the capacity to submit tenders only for certain portions. On the other hand, permitting partial tenders can complicate the process of comparing tenders.

8. The procurement documents must specify the portion or portions of the goods or construction for which partial tenders may be submitted (article 18(h)). A procuring entity may not merely decide to divide the entirety of the goods or construction to be procured into separate contracts as it sees fit after tenders are submitted. A partial tender is responsive if it conforms with the procurement documents.

#### Paragraph[s (5) and] (6)]

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 135, 136; A/CN.9/315, paras. 70-74, 88, 89]

9. [These two paragraphs concern the question of alternative tenders. Paragraph (5) deals with cases in which the procurement documents solicit from contractors and suppliers alternatives to the characteristics of the goods or construction, contractual terms and conditions or other requirements set forth in the procurement documents.] Paragraph (6) deals with unsolicited alternative tenders submitted by contractors and suppliers.

[10. In the case of solicited alternative tenders, the procurement documents may, but need not, indicate the characteristics, contractual terms and conditions or other requirements in respect of which alternatives are solicited. Alternative tenders that are expressly solicited by the procurement documents should not be regarded as non-responsive *per se*.]

11. Unlike solicited alternative tenders, unsolicited alternative tenders are non-responsive. Nevertheless, there may be exceptional cases in which the procuring entity

may wish to be able to consider potentially advantageous but unsolicited alternative tenders. Paragraph (6) enables it to do so, in its discretion, and sets forth conditions and rules governing the consideration of such tenders intended to ensure fair treatment of contractors and suppliers that have submitted responsive tenders. In some cases, the procuring entity may prefer to reject all tenders pursuant to article 29 and to begin new tendering proceedings based on the alternative tender.

[Working Group note: Paragraph (5) has been included because the Working Group called for provisions dealing with alternative tenders (A/CN.9/315, especially para. 74). However, that paragraph and the corresponding portions of the foregoing commentary have been placed within square brackets because a provision dealing with solicited alternative tenders, which is the subject of paragraph (5), may not be needed. This is because an alternative tender that is submitted pursuant to an express solicitation of alternative tenders in the procurement documents is not *per se* unresponsive, and should be treated as any other tender.]

[Two alternative versions of paragraph (6) are presented. Under alternative 1, the procuring entity may consider an alternative tender only from the contractor or supplier that submitted the most advantageous responsive tender. Under alternative 2, an alternative tender may be considered even if the contractor or supplier did not submit a responsive tender, as long as eligible and qualified contractors and suppliers that submitted responsive tenders have an opportunity to alter their tenders or to submit additional tenders based on the alternative. Both approaches seek to reconcile the interest of the procuring entity in being able to consider an alternative tender with the policies of fairness and competition. Arguments already expressed by the Working Group with respect to these approaches are set forth in A/CN.9/315, paras. 71 to 73. Several experts on procurement consulted by the Secretariat have favoured the approach in alternative 1.]

#### Paragraph (7)

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 169-188; A/CN.9/315, paras. 90-100]

12. The rules in paragraph (7) reflect an essential feature of tendering proceedings, namely, that the evaluation and comparison of tenders is to be carried out in an objective manner and in accordance with objective and quantifiable criteria, to the extent possible, set forth in the procurement documents (see article 18(p)). Paragraph (7)(c) addresses itself to the criteria for evaluating and comparing tenders. The procuring entity must decide, and specify in the procurement documents, whether the most advantageous tender will be deemed to be the one with the lowest tender price or the one found to be the most economically advantageous. The most economically advantageous tender is to be ascertained on the basis of criteria of the nature indicated in paragraph (7)(c)(ii). That provision enumerates as examples a number of possible criteria. A central feature of those criteria is that they must be objective and quantifiable to the extent possible. Requiring the criteria to be of that nature preserves the essential element of competition in tendering proceedings by enabling tenders to be

evaluated and compared on a common basis. In addition, by reducing the scope for discretionary or arbitrary decisions, it promotes certainty and confidence in the tendering proceedings. The procuring entity must, for each particular tendering proceedings, decide which specific criteria to employ in accordance with the nature of the procurement.

13. The qualifying words "to the extent possible" are included because not all permissible criteria will be wholly objective and devoid of judgmental factors. For example, in procuring lorries, one criterion of importance to the procuring entity may be the ergonomics of the driver's seat. The evaluation of the ergonomics of a seat proposed in a tender will of necessity be subjective to some extent. However, pursuant to the requirement that the evaluation and comparison of tenders be carried out "in an objective manner", the procuring entity may evaluate the ergonomic qualities of the seat in each tender by assigning a certain number of points within a given range depending upon the relative degree of ergonomic superiority that the seat is adjudged to possess.

14. The evaluation criteria referred to in paragraph (7)(c)(ii) do not include criteria that are the subjects of required characteristics, terms or conditions set forth in the procurement documents (see article 18(e) and (f) and paragraph 3 of the commentary to article 18) to which tenders must conform. If those required features are deviated from, the tender is non-responsive; the extent of deviation or conformity is not quantified or evaluated in ascertaining the most economically advantageous tender. By contrast, the non-required characteristics, terms and conditions referred to in paragraph (7)(c)(ii) are to be evaluated and compared for the purpose of ascertaining the most economically advantageous tender.

15. The following examples are given to illustrate the foregoing distinction. In the first example, it is important to the procuring entity that the goods to be procured be delivered by a particular date, and the procuring entity does not regard earlier delivery as beneficial. It specifies the delivery date in the procurement documents. A tender that provided for delivery at a later date would be unresponsive. A tender that provided for delivery at an earlier date would not be unresponsive; however, no advantage in the evaluation and comparison of tenders would be given to such a tender. In the second example, the procuring entity wishes contractors and suppliers to make their best offers with respect to the delivery date. It stipulates in the procurement documents that the time of delivery will be a factor to be taken into account in the evaluation and comparison of tenders, with early delivery being advantageous. It might even indicate a desired delivery date, without, however, requiring delivery by that date. The evaluation and comparison of tenders would take into account the delivery times offered together with the other criteria set forth in the procurement documents in order to ascertain the most advantageous tender.

16. Ascertaining the most advantageous tender on the basis of the tender price alone provides the greatest objectivity and automaticity. It is also relatively easy to administer. However, it is also the less flexible of the two pos-

sible approaches, since criteria other than price that may make certain tenders more or less advantageous than others cannot be taken into account. Under this approach, therefore, the procuring entity must take care to formulate its specifications, terms, conditions and other requirements with sufficient completeness and precision so that all tenders conforming to them will satisfactorily meet the procuring entity's needs, and so that the relative advantages of the tenders will be reflected in the tender prices alone. It is therefore most appropriate for relatively simple, routine goods or construction.

17. The approach under which the procuring entity ascertains the most economically advantageous tender on the basis of criteria in addition to the tender price offers greater flexibility than the approach based on the tender price alone. It permits the relative advantages of tenders to be compared along a broader spectrum of parameters. This may be increasingly important as the goods or construction become less standardized and more complex.

18. Pursuant to paragraph (7)(b), the evaluation and comparison of tenders must be carried out in an objective manner. When the most advantageous tender is to be the one with the lowest tender price, the method of evaluating and comparing tenders is relatively straightforward—tender prices alone are compared.

19. When the most advantageous tender is the one that is the most economically advantageous, the method of evaluation and comparing tenders is more complicated. One possible method is to quantify in monetary terms the various aspects of each tender in relation to the criteria set forth in the procurement documents and to combine those quantifications with the tender price. The tender resulting in the lowest evaluated price is regarded as the most economically advantageous tender. Another method may be to assign relative weightings (e.g., "coefficients" or "merit points") to the various aspects of each tender in relation to the criteria set forth in the procurement documents. The tender with the most favourable aggregate weighting is the most economically advantageous tender. The manner in which the weightings will be assigned should be specified in the procurement documents.

20. Paragraph (7)(d) has been included because, in some countries, particularly developing countries, it is important for procuring entities to be able to take into account criteria to permit the evaluation and comparison of tenders in the context of economic development objectives. Such criteria are sometimes less objective and more discretionary than those referred to in paragraph (7)(c)(ii). In some cases, therefore, their use in evaluating and comparing tenders could impair competition and reduce economy in procurement and confidence in the procurement process. The provision has been placed within square brackets with the intention that it would be included by an implementing State in which the ability of procuring entities to use such criteria is of particular importance, but need not be included by other implementing States.

21. Paragraph (7)(d) has been formulated with the objective of minimizing the possible disadvantageous consequences mentioned in the preceding paragraph. Firstly, a

procuring entity may not use the criteria as the sole basis for the evaluation and comparison of tenders; it may apply the criteria only "in addition to the criteria of the nature referred to in paragraph (7)(c)(ii)". Thus, even if the additional criteria permitted by the provision are less than objective, there will remain a sound objective element to the evaluation and comparison of tenders. Secondly, "to the extent possible" the additional criteria must themselves be expressed in objective and quantifiable terms. For example, as an indication of the effect of a tender on the country's foreign exchange reserves, a criterion might be the extent to which the tenderer will accept payment in the local currency; as an indication of the extent to which a tender promotes the development of domestic industries, a criterion might be the extent to which domestic labour or subcontractors would participate in the manufacture of the goods or in the construction or the degree of domestic content or domestic value added in the goods; as an indication of the degree of transfer of technology to the country, a criterion might be the extent of the undertaking in a tender to train local personnel. Thirdly, the additional criteria must be designed to ascertain the impact of tenders in relation to "specific" Government economic programmes or policies. These criteria do not include those that are the subject of required contractual terms or conditions (see paragraph 14 of the present commentary).

22. Paragraph (7)(e) permits a procuring entity to grant a margin of preference to domestic tenders and sets forth rules for its application. Its purpose is to promote national economic development and the development of domestic industry. It should be noted, however, that States that are parties to the GATT Procurement Agreement and member States of the EEC may be restricted in their ability to accord such preferential treatment. The procurement regulations may establish criteria for qualifying as a "domestic" contractor or supplier (e.g., that the contractor or supplier be registered in the implementing State, that it have majority ownership by nationals of the implementing State, and that it not subcontract more than 50% of the value of the construction to foreign contractors or suppliers) and for qualifying as "domestically produced" goods (e.g., that they contain a minimum domestic content or value added). The procurement regulations should also set forth the amount of the margin of preference. Differing amounts might be set forth for goods and for construction.

[Working Group note: As a technique for achieving the economic objectives mentioned above, it may be preferable to enable both foreign and domestic contractors and suppliers to participate in tendering proceedings but to give a margin of preference to domestic contractors and suppliers, rather than to restrict participation and procurement to domestic tenderers alone. One economic analysis has concluded that the former technique could reduce the cost of procurement by increasing the competitive pressures on foreign contractors and suppliers, compelling them to submit lower tender prices. The latter technique, on the other hand, tends to lead to higher procurement costs because it does not contain those competitive incentives and, in fact, restricts competition. McAlee and McMillan, "Government Procurement and International Trade", *Journal of International Economics*, vol. 26, pp. 291-308 (1989).]



23. In some cases, a procuring entity may wish to use a "two envelope" system for opening, evaluating and comparing tenders. Under that system, the procurement documents require contractors and suppliers to organize their tenders into two sealed envelopes, the first envelope containing documents and information relative to the eligibility and qualifications of the contractor or supplier and the technical, contractual and other components of the tender other than the tender price, and the second envelope containing only the tender price. At the opening of tenders, the procuring entity opens the first envelopes and examines the tender components contained therein with respect to the eligibility and qualifications of contractors and suppliers and with respect to the responsiveness of the tenders. It then evaluates the tender components contained in the first envelopes of tenders that have not been rejected (e.g., with respect to the technical characteristics of the goods or construction and the contractual terms and conditions, excluding price, contained in the tenders). The procuring entity then opens the second envelopes (i.e., the envelopes containing the tender prices) of tenders that have not been rejected, and factors the tender price into the evaluation of each tender. The evaluations of the tenders are then compared in order to ascertain the most economically advantageous tender. The reason for using this system is to ensure that the procuring entity evaluates the non-price aspects of each tender without being influenced by the price. If such a system is used, the procedures and evaluation criteria should be set forth in the procurement documents.

*Paragraph (8)*

[Working Group note: sources: A/CN.9/WG.V/WP.22, para. 179 A/CN.9/315, paras. 95, 96]

24. When two or more currencies are used for expressing tender prices, the tender prices will have to be converted to a single currency in order to permit tenders to be compared on a common basis. (Pursuant to article 2(g), "currency" includes unit of account.) This paragraph sets forth rules with respect to the conversion. The conversion is to be made only for the purpose of comparing and evaluating tenders; it does not concern the question of the currency or currencies in which the contract price is to be paid.

25. The tender prices may be converted to a national currency, such as the currency of the country of the procuring entity. However, in order to reduce possible distortions in the relative values of tender prices due to distortions in the valuation of the various currencies used in the tenders against the currency used as the common basis for comparison (e.g., currencies used in some tenders may be overvalued while others may be undervalued), a procuring entity may wish to use as the basis for comparison either an internationally used unit of account consisting of a basket of currencies (e.g., the Special Drawing Right (SDR) of the International Monetary Fund) or a relatively stable national currency customarily used in international trade.

26. The procurement documents must set forth the currency that will be used for evaluating and comparing tenders and the exchange rate or the means of determining

the exchange rate to be used to convert tenders into that currency (article 18(q)).

*Paragraph (10)*

27. The existing practice in some countries is for the procuring entity to take the final decision as to which tender is to be regarded the most advantageous. In other countries, the determination of the procuring entity is only provisional and is subject to approval by a higher authority, such as the relevant minister or the central procurement board (see paragraph 1 of commentary to article 6). Paragraph (10) has been placed within square brackets indicating that it may be included or excluded depending upon the customary or desired practice of the implementing State.

*Article 29. Rejection of all tenders*

(1) Subject to approval, the procuring entity may, at any time prior to the entry into force of the procurement contract, reject all tenders for any reason other than those set forth in article 28(2) or (3). However, the procuring entity may not reject all tenders for the purpose of invoking article 7(2)(b)(i) or for any fraudulent purpose.

(2) The procuring entity shall incur no liability, solely by virtue of its invoking paragraph (1), towards contractors and suppliers that have submitted tenders nor any obligation to inform them of the grounds for its action.

(3) Notice of the rejection of all tenders pursuant to this article shall be given promptly, in writing or by any other means that provides a record of the information contained therein, to all contractors and suppliers that submitted tenders.

*Commentary*

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 193, 194; A/CN.9/315, paras. 102-104]

1. A procuring entity may wish to reserve the right to reject all tenders in the public interest, such as where there appears to have been a lack of competition or to have been collusion in the tendering proceedings, where the procuring entity's need for the goods or construction ceases or where the procurement can no longer take place due to a change in Government policy or a withdrawal of funding. Public law in some countries may restrict the exercise of this right, e.g., by prohibiting action constituting an *abus de droit* or a violation of fundamental principles of justice.

2. In invoking this article the procuring entity must reject all tenders, not just certain ones. If all tenders are rejected the procuring entity may engage in the procurement by using competitive negotiation proceedings (article 7(2)(b)(i)). However, the procuring entity may not reject all tenders for the purpose of engaging in competitive negotiation proceedings, or for any fraudulent purpose.

3. Pursuant to paragraph (2), the procuring entity incurs no liability towards contractors and suppliers, such as compensation for their costs of preparing and submitting tenders, solely by virtue of its invoking paragraph (1).

**Article 30. Negotiations with contractors and suppliers**

(1) No negotiations shall take place between the procuring entity and a contractor or suppliers with respect to a tender submitted by the contractor or supplier except that:

(a) if the procurement documents specify a maximum price for the goods or construction or a range of prices within which tender prices must fall, and all otherwise responsive tenders from eligible and qualified contractors and suppliers exceed that maximum price or range or prices, the procuring entity may negotiate with the contractor or supplier submitting the tender with the lowest price with a view towards reducing its tender price;

(b) if it appears from the evaluation and comparison of tenders that no one tender is obviously the most advantageous, the procuring entity may negotiate with contractors and suppliers whose tenders appear to be more advantageous than others with a view towards the modification of one of those tenders so that it is more advantageous than the others.

(2) No negotiations permitted by paragraph (1) shall take place concerning any required characteristics of the goods or construction, or any required contractual term or condition, set forth in the procurement documents.

*Commentary*

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 170, 189-192; A/CN.9/315, para. 101]

1. Except in the two cases specifically mentioned in paragraph (1), negotiations between the procuring entity and tenderers are not permitted. (See, however, article 31.) The model law provides in appropriate cases for procurement by competitive negotiation and for single-source procurement, in both of which negotiations of a broad scope are possible (see article 7(2) and (3)). With respect to the reference to a maximum price or a range of prices in paragraph (1)(a), see paragraphs 5 and 6 of commentary to article 28.

2. The rule contained in paragraph (2) is intended to preserve the elements of uniformity in the evaluation and comparison of tenders and fairness to contractors and suppliers that submit responsive tenders. See, also paragraphs 14 and 15 of the commentary to article 28.

**Section VIII. Special tendering procedures for solicitation of proposals**

**Article 31. Special tendering procedures for solicitation of proposals**

(1) Subject to approval, the procuring entity may employ the procedures provided for in this article in cases where it seeks proposals from contractors and suppliers with respect to the technical characteristics of the goods or construction to be procured because multiple alternative technical solutions might meet the needs of the procuring entity or because, due to the nature of the

goods or construction, the procuring entity is unable to formulate detailed technical characteristics.

(2) The provisions of chapter II of this Law shall apply to tendering proceedings in which the procedures provided for in the present article are employed except to the extent those provisions are derogated from in the present article.

(3) The procurement documents shall call upon contractors and suppliers to submit initial tenders containing their proposals without a tender price.

(4) The procuring entity may engage in discussions with any contractor or supplier whose tender has not been rejected pursuant to article 28(2) or (3) or 29 concerning any aspect of its tender, other than a required characteristic of the goods or construction or a required contractual term or condition set forth in the procurement documents.

(5) The procuring entity shall invite contractors and suppliers whose tenders have not been rejected to submit final tenders with prices. A contractor or supplier not wishing to submit a final tender may withdraw from the tendering proceedings without forfeiting its tender security. The final tenders shall be evaluated and compared in order to ascertain the most advantageous tender.

(6) The procuring entity shall include in the minutes required under article 33 a statement of the circumstances on which it relied in invoking the provisions of this article, specifying the relevant facts.

*Commentary*

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 60-61; A/CN.9/315, para. 113. This article concerns the proceedings referred to in the above-mentioned documents as "competitive negotiation" proceedings. In the present draft that term has been used for the proceedings provided for in article 7(2) and article 34, for reasons given in the commentary to article 34.]

1. In principle, tenders must be evaluated and compared uniformly on the basis of detailed technical specifications and contractual terms and conditions formulated by the procuring entity, with no negotiations being permitted between the procuring entity and contractors and suppliers, except as provided in article 30. The present article provides procedures for use where, for the reasons stated in paragraph (1), the procuring entity does not or cannot formulate its technical requirements in detail. This may be the case, for example, where the procuring entity wishes to receive various proposals for technical solutions as to its procurement need (e.g., the construction of a bridge) or where the procuring entity seeks to procure a piece of non-standardized, technologically-advanced equipment for which it can formulate only general performance criteria, and relies on contractors and suppliers to propose designs or develop technologies to meet those criteria. The procedures might be used, for example, in turnkey or "design and construct" projects. However, the procedures should be regarded as exceptional. Their use must be approved (see paragraph 1 of the commentary to article 6), and the

procuring entity must set forth in the minutes of the tendering proceedings its justification for invoking the procedures. If the article is invoked the procedures to be followed must be set forth in the procurement documents (article 18(p)).

2. These procedures are to be employed in the context of tendering proceedings. Thus, pursuant to paragraph (2), the provisions of chapter II of the model law apply to the proceedings except to the extent those provisions are derogated from in the present article. For example, the technical and other parameters of the goods or construction to which proposals must conform must be set forth in the procurement documents in an objective manner to the extent possible (article 20(2)). Those parameters might include, for example, design parameters (e.g., dimensions), and quality, safety and performance characteristics of the goods or construction.

3. With respect to the reference to "a required characteristic of the goods or construction" in paragraph (4), see paragraphs 14 and 15 of the commentary to article 28 and paragraph 2 of the commentary to article 30.

*Section IX. Acceptance of tender and entry into force of procurement contract; minutes of tendering proceedings*

*Article 32. Acceptance of tender and entry into force of procurement contract*

(1) [Subject to approval,] the tender that has been ascertained to be the most advantageous shall be accepted. Notice of acceptance of the tender shall be given promptly to the contractor or supplier that submitted the tender.

(2) A procurement contract in accordance with the terms and conditions of the accepted tender enters into force when the notice referred to in paragraph (1) is [dispatched to] [received by] the contractor or supplier that submitted the tender, provided that it is [dispatched] [received] while the tender is in force and effect.

(3)(a) Notwithstanding the provisions of paragraph (2), the notice referred to in paragraph (1) may require the contractor or supplier whose tender has been accepted to sign a written procurement contract conforming to the tender. The contractor or supplier shall sign the written procurement contract within a reasonable period of time after the notice is [dispatched to] [received by] it.

(b) The procurement contract enters into force when the written procurement contract is signed by the contractor or supplier and by the procuring entity. Between the time when the notice referred to in paragraph (1) is [dispatched to] [received by] the contractor or supplier until the entry into force of the procurement contract, the contractor or supplier shall take no action which interferes with the entry into force of the procurement contract or with its performance.

(4) If the contractor or supplier whose tender has been accepted fails to sign a written procurement contract, if required to do so, or fails to provide any required security for the performance of the contract, the tender that is ascertained to be the next most advantageous tender and that is in force and effect may be accepted [subject to approval]. The notice provided for in paragraph (1) shall be given to the contractor or supplier that submitted that tender.

(5) Upon the entry into force of the procurement contract and the provision by the contractor or supplier of a security for the performance of the contract, if required, notice of the procurement contract shall be given to other contractors and suppliers, specifying the name and address of the contractor or supplier that has entered into the contract and the price of the contract.

(6)(a) The notices referred to in this article may be given in writing or by any other means that provides a record of the information contained therein.

(b) [Alternative 1: The notice under paragraph (1) is "dispatched" when it is properly addressed or otherwise directed and transmitted to the contractor or supplier, or conveyed to an appropriate authority for transmission to the contractor or supplier, by a mode authorized by paragraph (6)(a).]

[Alternative 2: The notice referred to in paragraph (1) is "received" by the contractor or supplier when it is received by it personally or at its place of business or mailing address.]

*Commentary:*

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 195-199; A/CN.9/315, paras. 105-107]

1. Paragraphs (2) and (3) set forth uniform legal rules with respect to the entry into force of the procurement contract. The entry into force of the contract is distinguished from the arising of obligations under the contract. For example, a procurement contract may have entered into force in accordance with the rules in the present article, but under the contract the obligations of the contractor or supplier may be subject to a condition (e.g., that the procuring entity obtain necessary import licences).

[Working Group note: In connection with paragraphs (2) and (3), the Working Group may wish to consider whether to follow the "dispatch" or "receipt" approach with respect to the notice. The "receipt" approach is used in the United Nations Sales Convention, article 18(2). The Working Group might consider, however, whether the "dispatch" approach is more appropriate in the particular circumstances of procurement. In essence, what is at stake is the risk of a delay or a failure in the transmission of the notice. In order to bind the contractor or supplier to a procurement contract or obligate it to sign a written procurement contract, the procuring entity must give the notice while the tender is in force and effect. Under the "receipt" approach, if the notice was properly transmitted or conveyed to a transmitting authority by the procuring entity, but the transmission was delayed, lost or misdirected due to no fault of the procuring entity, so that the notice was not received by the contractor or supplier

before the expiry of the period of effectiveness of its tender, the procuring entity would lose its right to bind or obligate the contractor or supplier. Under the "dispatch" theory, that right of the procuring entity would be preserved. In the event of a delay, loss or misdirection of the notice, the contractor or supplier might not learn before the expiration of the period of effectiveness of its tender that the tender had been accepted; but in most cases, that consequence would be less severe than the loss of the right of the procuring entity to bind the contractor or supplier. Paragraph (6)(b) defines the time when the notice is ["dispatched to"] ["received by"] the contractor or supplier. The definition of "dispatched" is based upon a definition set forth in the UNCITRAL Construction Legal Guide, chapter IV, "General remarks on drafting", para. 25. The definition of "received" is based upon the definition set forth in the United Nations Sales Convention, article 24.]

2. Paragraph (3) sets forth rules concerning the signing of the contract, the entry into force of the contract and obligations of the contractor or supplier. As long as the notice to the contractor or supplier is timely, the contractor or supplier is obligated to sign a written procurement contract within a reasonable period of time after the notice, even if the period of effectiveness of its tender expires after the notice is given but before the contract is signed.

3. The approach followed by paragraph (2), under which the procurement contract enters into force upon giving notice to the contractor or supplier, may be satisfactory where there are no outstanding issues concerning the contract to be resolved and where all relevant terms are covered by the tender. The approach followed by paragraph (3), under which a written procurement contract must be signed, may be desirable where there exist outstanding contractual terms to be settled by the parties.

4. Under paragraph (4) the next most advantageous tender may be accepted if the contractor or supplier submitting the tender originally accepted fails to sign a written procurement contract, if required to do so, or fails to supply a required security for performance of the contract. The procuring entity may also exercise its rights under a tender security provided by the contractor or supplier that fails to perform those acts.

#### Article 33. *Minutes of tendering proceedings*

(1) The procuring entity shall prepare minutes of the tendering proceedings, including the opening, examination, evaluation and comparison of tenders. The minutes shall contain a brief description of the goods or construction to be procured, the names and addresses of contractors and suppliers that submitted tenders; information relative to the eligibility and qualifications, or lack thereof, of those contractors and suppliers; the price and a summary of the other principal terms and conditions of each tender and of the procurement contract; a summary of the evaluation and comparison of tenders; if all tenders were rejected pursuant to article 29, a statement to that effect; and, where applicable, the statement required by article 31(6).

(2) The minutes of the tendering proceedings shall be made available for inspection by the general public after a procurement contract has entered into force and the contractor or supplier has supplied a security for the performance of the contract, if required, or after tendering proceedings have been terminated without resulting in a procurement contract. However, no information shall be disclosed contrary to any law of [this State] relating to confidentiality.

#### *Commentary*

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 156, 200; A/CN.9/315, paras. 85, 103, 108]

The purpose of these provisions is to promote transparency of the tendering proceedings and to assist an aggrieved contractor or supplier to exercise its right to seek redress against improper procedures used or improper decisions taken by the procuring entity.

### Chapter III. Procurement other than by means of tendering proceedings

#### Article 34. *Competitive negotiation proceedings*

(1) In competitive negotiation proceedings, the procuring entity shall engage in negotiations with a sufficient number of contractors and supplier to ensure effective competition, but in any case with at least [3] contractors and suppliers unless negotiations with [3] contractors and suppliers are not possible or are not practicable.

(2) Any requirements, guidelines, documents or other information relative to the negotiations that are communicated by the procuring entity to a contractor or supplier shall be communicated on an equal basis to all other contractors and suppliers engaging in negotiations with the procuring entity relative to the procurement; provided, however, that the foregoing provision shall not apply to documents or other information that is particular to negotiations with an individual contractor or supplier or to documents or information the disclosure of which would be contrary to any law of [this State] relating to confidentiality.

(3) Negotiations between the procuring entity and a contractor or supplier shall be confidential, and except as provided in paragraph (4), one party to those negotiations shall not reveal or disclose to any third person any documentation or information relating to those negotiations without the consent of the other party.

(4)(a) The procuring entity shall prepare minutes of the competitive negotiation proceedings. The minutes shall contain the names and addresses of contractors and suppliers with which the procuring entity has engaged in negotiations; the price and a summary of the other principal terms and conditions of the procurement contract; if the proceedings did not result in a procurement contract, a statement of the reasons therefor; and the statement and facts required by article 7(5).

(b) The minutes of the competitive negotiation proceedings shall be made available for inspection by

the general public after a procurement contract has entered into force, except that no information shall be disclosed contrary to any law of [this State] relating to confidentiality.

#### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras 201-212; A/CN.9/315, paras. 109-112. The use of the term "competitive negotiation proceedings" in reference to the proceedings provided for in this article is different from the use of that term in A/CN.9/WG.V/WP.22. In that document, the term is used to describe the procedures that are provided for in article 31 of the present text. The term "competitive negotiation proceedings" as used in the present text is defined in article 2(h).]

1. Competitive negotiation proceedings may be engaged in the circumstances set forth in article 7(2). Subject to the rules set forth in the model law and in the procurement regulations, and subject to any rules of the applicable law, the procuring entity may organize and conduct the negotiations as it sees fit. The rules set forth in the present article are intended to allow that freedom to the procuring entity while incorporating an element of competition into the proceedings. In addition, various other articles of the model law apply to competitive negotiation proceedings, such as article 8 (eligibility of contractors and suppliers), article 9 (qualifications of contractors and suppliers) and article 10 (rules concerning written statements and documentary evidence provided by contractors and suppliers). In addition, the negotiations will be subject to any rules set forth in the procurement regulations and to any other rules of the applicable law.

2. Paragraph (1) allows considerable latitude to the procuring entity to choose the contractors and suppliers with which to negotiate. In general, however, the procuring entity must negotiate with a sufficient number of contractors and suppliers to ensure effective competition. [Working Group note: The required minimum number of contractors and suppliers has been placed within square brackets in order to invite the Working Group to consider the minimum number that should be required.] With respect to the final words of the paragraph, negotiations with the required minimum number of contractors and suppliers may be regarded as not possible or practicable if, for example, the goods or construction to be procured can be supplied only by a fewer number of contractors and suppliers.

3. It is often desirable for the procuring entity to establish basic rules and procedures relating to the conduct of the negotiations in order to help ensure that they proceed in an efficient manner. In addition, it is often useful for the procuring entity to prepare various documents to serve as a basis for the negotiations, including documents setting forth the desired technical characteristics of the goods or construction to be procured, and the desired contractual terms and conditions. Although many of these characteristics, terms and conditions will be subjects of the negotiations, they at least can serve as an indication of the desires of the procuring entity and a starting point for the negotiations. Documents of this nature are particularly useful where the procuring entity solicits proposals from contractors or suppliers.

4. In some cases, it is useful for the procuring entity, prior to the commencement of negotiations, to establish an estimated price for the goods or construction to be procured. Establishing an estimated price will serve as a guideline to the procuring entity in negotiating and agreeing upon a price that is fair and reasonable.

5. The procuring entity may find it useful in some cases to require the contractors and suppliers with which it negotiates to itemize their prices so as to enable the procuring entity to compare what is being offered by one contractor or supplier during the negotiations with what is being offered by the others. This, too, can help the procuring entity to evaluate and compare the offers of each contractor and supplier during the negotiations. [Working Group note: in accordance with the suggestion in A/CN.9/315, para. 112, the foregoing sentences have been adopted from the UNCITRAL Construction Legal Guide, Chapter III, "Selection of contractor and conclusion of contract", para. 46.] In addition, the procuring entity may find it desirable in some cases to seek to inspect contractors' and suppliers' relevant books or financial records and their construction, manufacturing or supply facilities.

6. The form that the contract must take (e.g., whether or not it must be in writing) is governed by the applicable law. Particularly in the case of complex goods or construction, it may be desirable for the procuring entity and each contractor and supplier with which it negotiates to stipulate, where permitted by the applicable law, that no contractual obligations exist between the parties until such time as a written contract has been entered into between them. [Working Group note: see UNCITRAL Construction Legal Guide, chapter III, "Selection of contractor and conclusion of contract", paras. 44 and 49]. The means and time at which a contract enters into existence will also be governed by the applicable law. Where the applicable law is the United Nations Convention on Contracts for the International Sale of Goods, matters such as those referred to in this paragraph will be subject to the internationally uniform rules contained in the Convention.

7. With respect to paragraph (4), see the commentary to article 33.

#### Article 35. Record of single source procurement

(1) The procuring entity shall prepare a record of the single source procurement. The record shall contain the name and address of the contractor or supplier from which the procuring entity procured the goods or construction, the price and a summary of the other principal terms and conditions of the procurement contract and the statement and facts required by article 7(5).

(2) The record shall be made available for inspection by the general public after the procurement contract has entered into force; provided, however, that no information shall be disclosed contrary to any law of [this State] relating to confidentiality.

#### Commentary

[Working Group note: sources: A/CN.9/WG.V/WP.22, paras. 62, 213; A/CN.9/315, para. 113]

The procuring entity may engage in single source procurement proceedings as it sees fit, subject to this article and other applicable provisions of the model law (e.g., article 8 (eligibility of contractors and suppliers), article 9 (qualifications of contractors and suppliers) and article 10 (rules concerning written statements and documentary

evidence provided by contractors and suppliers)), to any rules set forth in the procurement regulations and to any other rules of the applicable law. This article requires a relatively simple record of the procurement to be prepared and made available for public inspection (see the commentary to article 33).

### III. INTERNATIONAL COUNTERTRADE

#### International countertrade: draft legal guide on drawing up contracts in international countertrade transactions: sample chapters\*: report of the Secretary-General

(A/CN.9/332 and Add. 1 to 7) [Original: English]

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\*The chapters are first drafts prepared by the secretariat for consideration by the Commission as part of the preparatory work on the draft legal guide on drawing up contracts in international countertrade transactions and should not be regarded as stating the views of the Commission.

[A/CN.9/332]

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

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

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

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

4. Addenda 1 to 7 to the present document contain an outline of chapter I and sample draft chapters II to VI, IX and XII of the draft legal guide. During the preparation of the draft chapters, including preliminary drafts of chapters that are not contained in addenda to this report, the Secretariat found it desirable to modify the titles, structure and the sequential order of certain chapters, as the chapters were originally set out in document A/CN.9/322 ("Draft outline of the possible content and structure of a legal guide on drawing up international countertrade contracts").

5. In preparing the draft chapters the Secretariat has taken into account a broad range of relevant documents, contracts, books and articles. In addition, the Secretariat has benefited from the comments of an expert group which met at Vienna from 12 to 15 December 1989.

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

I. INTRODUCTION TO LEGAL GUIDE. An outline of the chapter is contained in addendum 1 to the present report.

II. SCOPE AND TERMINOLOGY OF LEGAL GUIDE. The draft chapter is contained in addendum 1 to the present report.

III. CONTRACTING APPROACH. The draft chapter is contained in addendum 2 to the present report.

IV. GENERAL REMARKS ON DRAFTING. The draft chapter is contained in addendum 3 to the present report.

V. TYPE, QUALITY AND QUANTITY OF GOODS. The draft chapter is contained in addendum 4 to the present report.

VI. PRICING OF GOODS. The draft chapter is contained in addendum 5 to the present report.

VII. FULFILMENT OF COUNTERTRADE COMMITMENT. The Secretariat intends to deal in the draft chapter with the time period for fulfilment of the countertrade commitment (length, commencement and extension of the fulfilment period) and with the division of the fulfilment period into subperiods. Furthermore, it is intended to address contractual mechanisms for monitoring and recording fulfilment of the countertrade commitment.

VIII. PARTICIPATION OF THIRD PERSONS. The Secretariat intends to deal in this chapter with issues to be addressed in the countertrade agreement if it is envisaged that a third person may be engaged to purchase goods required to be purchased in order to fulfil the countertrade commitment. The chapter would also address the contractual relationship between the party committed to purchase goods and the third person, and the relationship between the third person and the supplier of the goods. In addition, the chapter would discuss cases in which a third person is engaged to supply goods within the framework of the countertrade agreement.

IX. PAYMENT. The draft chapter is contained in addendum 6 to the present report.

X. RESTRICTIONS ON RESALE OF GOODS. The Secretariat intends that the legal guide discuss possible clauses in the countertrade agreement concerning various types of territorial restrictions on the resale of goods purchased in a countertrade transaction as well as restrictions concerning terms of resale.

XI. LIQUIDATED DAMAGES AND PENALTIES. This chapter would discuss various issues related to the use of liquidated damages or penalty clauses to support the countertrade commitment. These issues include the parties that may be made subject to such a clause, the effect of payment of the agreed sum, the amount of the agreed sum and obtaining the agreed sum.

<sup>1</sup>Official Records of the General Assembly, Forty-first Session, Supplement No. 17 (A/41/17), para. 243.

<sup>2</sup>Ibid., Forty-third Session, Supplement No. 17 (A/43/17), paras. 32-35.

<sup>3</sup>Ibid., Forty-fourth Session, Supplement No. 17 (A/44/17), paras. 245-249.



XII. SECURITY FOR PERFORMANCE. The draft chapter is contained in addendum 7 to the present report.

XIII. INTERDEPENDENCE OF OBLIGATIONS. It is intended that this chapter will discuss the extent to which a difficulty occurring in one segment of the transaction may have an effect on the other segment of the transaction.

XIV. CHOICE OF LAW.

XV. SETTLEMENT OF DISPUTES. The methods of settling disputes to be dealt with in the legal guide include negotiation, conciliation, arbitration and judicial proceedings. The legal guide would also address co-ordination between the dispute settlement clauses in the discrete contracts involved in a countertrade transaction. In addition the legal guide would discuss clauses to be used when more than two parties involved in a countertrade transaction wish to be joined in one dispute settlement proceeding.

7. The Commission may wish to note that the proposed time-table for the Commission's session, as set out in the provisional agenda (A/CN.9/327), provides that the first five days of the session would be devoted to a discussion of the subject of countertrade. It is suggested that the Commission use this period for an in-depth discussion of the draft legal guide. The Commission may wish to discuss the structure of the legal guide, as set out above in paragraph 6, and take up chapters I to VI, IX and XII (addenda 1-7 to the present report). The Commission may wish to consider the concept of the chapters, whether they cover the relevant issues, whether the statements made appropriately take into account the needs of countertrade practice and whether advice given is appropriate.

8. The Commission may wish to consider, on the basis of its discussion of the draft chapters and of the schedule of meetings of the Commission and its Working Groups during the remainder of 1990 and in 1991, the future procedure that should be followed in the preparation of the legal guide.

[A/CN.9/332/Add.1]

## CHAPTER I. INTRODUCTION TO LEGAL GUIDE

[The legal guide would have an introductory chapter describing the origin, purpose, approach and structure of the guide. It is suggested that it should be the last chapter to be drafted. At that time the structure of the legal guide would be clear including such issues as which chapters it would have, whether each chapter would be preceded by a chapter summary, and whether the guide would in some instances set forth illustrative contract provisions.]

In preparing the chapters the secretariat has, where appropriate, included suggestions as to how certain issues in a countertrade transaction might be settled. Three levels of suggestion have been used. The highest level is indicated

by expressions to the effect that the parties "should" take a particular course of action. It is used only when that course of action is a logical or legal necessity. This level is used sparingly in the legal guide. An intermediate level is used when it is "advisable" or "desirable", but not logically or legally required, that the parties adopt a particular course of action. Formulations such as "the parties may wish to consider" or "the parties might wish to provide", or the contract "might" contain a particular solution, are used for the lowest level of suggestion. The wording used for a particular suggestion may be, for drafting reasons, varied somewhat from that just indicated; however, it should be clear from the wording what level of suggestion is intended.

## CHAPTER II. SCOPE AND TERMINOLOGY OF LEGAL GUIDE

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## A. Transactions covered

1. Countertrade transactions dealt with in the legal guide are those international contractual arrangements under which one party supplies goods, services or technology to the second party, and, in return, the first party purchases or procures the purchase of an agreed amount of goods, services or technology from the second party, or from a party designated by the second party. (For the sake of simplicity, the legal guide will refer only to "goods" as the subject-matter of countertrade transactions, although the subject-matter of a given transaction may include services or technology.) A distinctive feature of these transactions is the existence of a link between the supply of goods in the two directions in that the conclusion of the contract or contracts for the supply of goods in one direction is conditioned upon the conclusion of the contract or contracts for the supply in the other direction. When the parties enter into contracts in opposite directions without expressing such a link between them, the contracts, as regards contractual rights and obligations of the parties, cannot be distinguished from straightforward independent transactions. Therefore, the legal guide deals only with transactions that express in a contractual form such a link between the contracts constituting the countertrade transaction.

2. Beyond this basic definition, countertrade transactions display a number of differing features. The differences concern such matters as the contractual structure of the transaction, the time sequence of conclusion of the component contracts, the underlying commercial interests of the parties, and other commercial and technical characteristics of the transactions. The legal guide takes into account that countertrade transactions display these differing features and that these features will affect the drawing up of the various contracts.

3. A countertrade transaction may be contractually structured in different ways. Often, the supply of goods in each direction is covered by a distinct contract. In such a case the link between these segments arising from the fact that the conclusion of the contract in one direction is conditioned upon the conclusion of the contract in the other direction may be expressed in an agreement separate from those contracts. In other cases that link may be expressed in a contract clause that is integrated into one of those contracts. In yet other cases, the whole transaction, i.e. the reciprocal supplying of goods and the stipulation expressing the link between the segments of the transaction, is incorporated into one contract (e.g., a barter contract). The legal guide discusses the implications of the choice of a particular contract structure or the choice of a particular contract form (see chapter III, "Contracting approach").

4. Furthermore, the contracts for the supply of goods in the two directions may be concluded at different points of time or they may be concluded simultaneously. When they are concluded at different points of time, which is often the case, the parties conclude an agreement expressing a commitment to conclude the future contract or contracts for the supply of goods. Such an agreement may be entered into together with the conclusion of the initial contract for the supply of goods in one direction or it may

be entered into prior to the conclusion of any supply contract. When the parties agree simultaneously on the supplies in both directions, the agreement between the parties would not include a commitment to conclude future contracts, but would establish a relationship between the performances due from each party. The legal guide refers to the particular sequence of the conclusion of the supply contracts when this is required by the context of the discussion.

5. Another aspect of the variety of countertrade transactions is the degree of interest the parties may have in the different segments of a countertrade transaction. In some transactions one of the parties is interested only in the export of its goods and would prefer to be free to decide whether to import goods from the other party. In other transactions, the parties consider the supply of goods in the two directions as being in their mutual interest. There are also transactions in which, at the outset of the transaction, a party perceives a commitment to conclude future contracts as a concession to the other party, but subsequently comes to regard that commitment as a benefit. The legal guide takes into account such possible differing degrees of interest that the parties may have in the different parts of the countertrade transaction and the impact that such differing degrees of interest may have on the contract or contracts.

6. Furthermore, a broad distinction among countertrade transactions may be made depending on whether the goods supplied in one direction are used in the production of the goods to be supplied in the other direction or whether no such technological link exists between the reciprocal deliveries. The legal guide will cover both of those varieties of countertrade and will make reference to a particular variety whenever appropriate.

7. A further distinction may be made on the basis of the number of the parties involved in a transaction. In some cases, the reciprocal deliveries of goods under the transaction are carried out between the same two parties. In other cases, on one side of the transaction, or on both, the roles of the seller and of the buyer are assumed by different persons. The legal guide addresses the contractual issues that are raised by the involvement of more than one party on either or both sides of a transaction.

## B. Terminology

8. Terminology used in practice and in writings to describe countertrade transactions and the parties involved in them varies greatly. A prevailing terminology has not developed. The following paragraphs establish a terminology used in the legal guide for different varieties of countertrade transactions, parties and contracts in countertrade.

### 1. Varieties of countertrade

9. The discussion in the legal guide is relevant to different commercial types of countertrade. In most instances, the contractual issues addressed in the legal guide are the same for all commercial types of countertrade transac-

tions, and the discussion in the legal guide generally does not distinguish among types of countertrade. However, in some contexts the discussion is particularly relevant to a commercial type of countertrade. Therefore, the terms used to denote such types of countertrade are explained below. The criteria used to distinguish the types of countertrade are based on commercial, technical and legal aspects of the transaction.

10. *Barter*. In practice the term "barter" is used with different meanings. The term may refer, for example, to countertrade transactions in general, to an intergovernmental agreement addressing mutual trade in particular goods between identified partners, or to countertrade in which trans-border flow of currency is eliminated or reduced or where a single contract governs the mutual shipments of goods. The legal guide uses "barter" in a strict legal sense to refer to a contract involving a two-way exchange of specified goods in which the supply of goods in one direction replaces, entirely or partly, the monetary payment for the supply of goods in the other direction. Where there is a difference in value in the supply of goods in the two directions, the settlement of the difference may be in money or in other economic value.

11. *Counter-purchase*. This term is used to refer to a transaction in which the parties, in connection with the conclusion of a purchase contract in one direction, enter into an agreement to conclude a sales contract in the other direction, i.e. a counter-purchase contract. Counter-purchase is distinguished from buy-back in that the goods supplied under the first purchase are not used in the production of the items sold in return.

12. *Buy-back*. This term refers to a transaction in which one party supplies a production facility, and the parties agree that the supplier of the facility, or a person designated by the supplier, will buy resultant products from the purchaser of the facility. The supplier of the facility often provides technology and training and sometimes component parts or materials to be used in the production.

13. *Offset*. Transactions referred to in the legal guide as offsets normally involve the supply of goods of high value or technological sophistication. Under a "direct offset" the contract for the supply of goods in one direction is combined with an agreement that the supplier will purchase from the other party component parts of, or products related to, those goods. Sometimes the supplier would also agree to provide technology or investment for the production by the other party of the component parts. Such direct offsets are also referred to as industrial participation or industrial co-operation. The expression "indirect offset" typically refers to a transaction where a governmental agency that procures, or approves the procurement of, goods of high value requires from the supplier that counter-purchases are made in the procuring country or that economic value is provided to the procuring country in the form of investment, technology or assistance in third markets. The counter-export goods are not technologically related to the export goods (i.e., they are not components of the export goods, as in direct offset, and they are not resultant products of the facility provided under the export contract, as in buy-back). The govern-

mental agency often stipulates guidelines for the offset, for example, as to the industrial sectors or regions that are to be assisted in such a way. However, within such guidelines, the party committed to counter-purchase or to providing such assistance is normally free to choose the contracting partners.

## 2. *Parties to countertrade transaction*

14. *Exporter or counter-importer*. The term "exporter" or "counter-importer" is used for the party who is—under the first contract to be concluded—the supplier, i.e. the exporter, of goods, and who has entered into a commitment with the other party to purchase, i.e. to counter-import, other goods in return. One or the other term is used depending on the context in which the party is mentioned. It should be noted that in some countertrade transactions the exporter and the counter-importer are the same party, while in others the exporter and counter-importer are different parties.

15. *Importer or counter-exporter*. The term "importer" or "counter-exporter" is used for the party who is—under the first contract to be concluded—the purchaser, i.e. the importer, of goods, and who has entered into a commitment with the other party to supply, i.e. to counter-export, other goods in return. One or the other term is used depending on the context in which the party is mentioned. As in respect of the exporter and the counter-importer, in some countertrade transactions the same party is the importer and the counter-exporter. Sometimes, however, one party imports and another party counter-exports.

16. In some writings the term "exporter" is used to denote the party from an economically developed country, who often supplies goods of technological content that normally cannot be obtained in the other party's country. The term is used irrespective of whether the "exporter" supplies first and agrees to purchase later or whether the "exporter" makes an "advance purchase" from the other party in order to enable that other party to raise funds needed for a subsequent purchase of goods from the "exporter". The term "importer" is used in those writings to denote the party from a developing country. To underline that meaning, such writings may use terms such as "primary" or "western exporter" or "developing country importer".

17. A distinction based on economic or regional considerations is not used in the present legal guide. One reason is that the guide covers both intra-regional and inter-regional countertrade. Thus, distinctions used in discussions of inter-regional countertrade, in which the issues tend to be considered primarily from the perspective of one of the parties, would not be suitable since the legal guide advises both parties whatever may be their relative economic strength or background. Furthermore, terms based on the time sequence of the conclusion of contracts are more suitable since, for the purpose of discussing the contractual role and interests of parties, the question of primary significance is whether the party has already sold its goods and has promised to purchase goods from the other party, or whether the party, having purchased goods, has not sold its goods yet.

18. *Purchaser, supplier or party.* The legal guide frequently uses the term "purchaser", "supplier" or "party" to refer to parties purchasing and supplying goods in a countertrade transaction. When reference is made to a party who is committed to purchase or supply goods but has not yet done so, the legal guide may use the terms "party committed to purchase goods" and "party committed to supply goods". Such terminology is employed when the discussion in the legal guide is relevant to the contractual position of a party purchasing or supplying goods irrespective of whether the purchase or supply in one direction takes place before or after the purchase or supply in the other direction. The order in which the shipments take place would not affect the contractual position and risks of the parties when the parties commit themselves to conclude contracts for the supply of goods without stipulating the sequence in which those contracts are to be concluded. Such terminology also covers cases in which the contracts for the supply of goods in the two directions are concluded concurrently and in which the sequence of the contracts cannot serve as a terminological criterion.

### 3. *Component contracts of a countertrade transaction*

19. *Countertrade agreement.* The countertrade agreement is the basic agreement which sets forth several stipulations concerning the type of countertrade transaction being entered into and the manner in which it is to be implemented. In practice, the countertrade agreement is referred to by a variety of names, such as "frame agreement", "countertrade protocol", "letter of intent", "umbrella agreement", "memorandum of understanding", "letter of undertaking", or "counterpurchase agreement". The countertrade agreement usually contains the commitment of the parties to enter into the future contracts required to fulfil the objective of the transaction ("countertrade commitment", see para. 20 below). In addition to the countertrade commitment, the countertrade agreement is likely to contain other stipulations on issues such as the type, quality and quantity of the goods, price of the goods, time period of fulfilment of the countertrade commitment, payment, restriction on resale of goods, participation of third persons in the transaction, liquidated damages or penalties, security for performance, interdependence of obligations in the transaction, choice of law, and settlement of disputes. The countertrade agreement may be embodied in a discrete instrument or it may be included in a contract for the shipment of goods. When the parties agree simultaneously on the terms governing the supply of all the goods in both directions, the countertrade agreement would contain a stipulation expressing the link between the concluded contracts and possibly other stipulations, but would not contain a countertrade commitment.

20. *Countertrade commitment.* This term is used to refer to the commitment of the parties to enter into a future contract or contracts. Depending on the circumstances, those future contracts may relate only to the shipment in one direction or to the shipments in both directions. The degree to which the countertrade commitment is definite depends on the amount of detail contained in the countertrade agreement concerning the terms of the future contracts.

21. *Export, import, counter-export, and counter-import contracts.* The contracts for the supply of goods entered into by the parties would be referred to by names consistent with the names of the parties, i.e. "export" or "import" contract for the first contract entered into, and "counter-export" or "counter-import" contract for the contract entered into subsequently. The contracts in each direction may be referred to in the singular even though there may be several such contracts on both sides of the countertrade transaction.

22. *Supply contracts.* In the cases mentioned above where no clear criterion exists for distinguishing between the exporter and the importer, or where the context requires a general reference to any party to the countertrade transaction, and in which the term "party" or "parties" to the countertrade transaction may be used, the contracts for the supply of goods between the parties may be referred to as "supply contracts".

23. *Countertrade transaction.* This term is used to refer to the whole countertrade arrangement containing the related supply contracts and any countertrade agreement.

### C. *Focus on issues specific to countertrade*

24. The contracts for individual supplies of goods under a countertrade transaction generally resemble contracts concluded as discrete and independent transactions. In some cases, however, the content of a contract is affected by the fact that it forms part of a countertrade transaction. For example, when the proceeds of a contract in one direction are to be used to pay for the contract in the other direction, the two supply contracts may contain payment provisions particular to countertrade. Therefore, the guide does not deal with supply contracts except to the extent that they contain provisions typical of countertrade.

25. The questions specific to or of particular importance for international countertrade are concentrated in the countertrade agreement. The legal guide focuses on questions raised in drawing up the countertrade agreement. Where necessary, reference is made to drawing up a provision in a supply contract that is influenced by the fact that the contract is part of the countertrade transaction.

26. Some of the issues dealt with in the legal guide are essential in establishing a countertrade transaction. For example, the parties would have to choose a contracting approach, express in appropriate form their commitment to engage in reciprocal trade, and specify the extent of the commitment. Solutions to certain other questions dealt with in the legal guide, while not necessarily essential, would help to ensure proper implementation of the transaction. Such questions include: the time period for the fulfilment of the countertrade commitment, type, quality, quantity and price of the countertrade goods, payment mechanism, participation of a third person in the fulfilment of the countertrade commitment, restrictions on resale of countertrade goods, security for performance, liquidated damages and penalties, possible effect on the countertrade transaction of problems arising in an individual contract for the supply of goods, choice of law, and

settlement of disputes. The parties intending to enter into a countertrade transaction are advised to address the essential questions. As to the other questions that are not necessarily essential but may be helpful in the implementation of the transaction, the parties will have to judge whether and to what extent the contractual solutions discussed in the legal guide are relevant to the circumstances of the given case.

#### D. Governmental regulations

27. In some countries countertrade is subject to governmental regulations. Such regulations, which may derive from international agreements, are closely linked with national economic policies and as a result vary from country to country and are likely to be changed more often than rules of contract law. Governmental regulations may promote or restrict countertrade in a variety of ways. For example, it may be provided that certain types of imports must be paid for only through a countertrade arrangement, that state trading agencies are to explore the possibility of countertrade when negotiating certain types of contracts, that certain types of local products are prohibited from being offered in countertrade, or that foreign currency payments into the country must not be restricted. Other such rules may relate to exchange controls or to the au-

thority of an administrative organ to approve a countertrade transaction. Some regulations may be specifically oriented to countertrade, while others may be more general, but with an impact on countertrade. Some regulations are directed to one contracting party only and do not directly affect the content or the legal effect of the contract concluded by that party. In other instances the regulation may limit the parties' freedom of contract.

28. The legal guide advises parties to take into account such governmental regulations. Since the regulations are disparate and are often changed, advice is given, where appropriate, in the form of a *caveat* rather than in any detailed discussion of the substance of the applicable regulations.

#### E. Universal scope of legal guide

29. The legal guide treats the legal issues arising from countertrade at the universal level, in view of the fact that the motives for engaging in countertrade, the interests of the parties involved, and the private law questions do not reveal regional particularities. To the extent there exist regional differences in contract practices, they concern in particular the frequency of use of certain commercial types of countertrade and the elaborateness and refinement of contractual solutions.

[A/CN.9/332/Add.2]

### CHAPTER III. CONTRACTING APPROACH

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## A. Choice of contract structure

1. A preliminary question the parties have to address is the contract structure of the countertrade transaction. The parties may embody the obligations in regard to the shipments of goods in the two directions in one contract or they may incorporate those obligations into separate contracts.

### 1. Single contract

2. Under a single contract approach the parties conclude one contract for the flow of goods in the two directions. Such a single contract may take the form of a barter contract or the form of a merged contract that contains all the contractual terms governing the reciprocal shipments.

#### (a) Barter contract

3. As noted in chapter II, "Scope and terminology of legal guide", paragraph 10, the legal guide uses the term barter in its strict legal sense to refer to a transaction involving an exchange of goods for goods, so that the supply of goods in one direction entirely or partly replaces the monetary payment for the supply of goods in the other direction. In a barter contract there is no need for a countertrade commitment since the parties agree at the outset of the transaction on all the contract terms for the shipments in the two directions. If the goods to be supplied in one direction are agreed to be of the same value as the goods to be supplied in the other direction, no monetary payment would be made. If the values are agreed to be different, the difference may be settled by monetary payment or by further delivery of goods. The parties may or may not express the value of the goods in monetary terms. If they do so, the attachment of a price to the goods serves to compare the value of the deliveries. The parties may have to express the value of shipments in monetary terms due to customs or other administrative requirements.

4. A factor that is often the main reason for using barter is that the use of barter eliminates or reduces the need for currency transfers. It may be noted, however, that the avoidance of currency transfers may also be achieved through the use of other contractual forms, namely, the parties may conclude separate sales contracts in each direction and agree to set off their mutual payment claims (such setoff of mutual claims is discussed in chapter IX, "Payment", paragraphs — to —).

5. There are several considerations that the parties may take into account in deciding whether to cast their countertrade transaction in the form of a barter contract. One consideration is that the conclusion of a barter contract implies a comparison between the values of the goods to be exchanged, which in turn implies that the type, quality and quantity of the goods should be specified at the time of conclusion of the contract. Conclusion of a barter contract would not be feasible when the parties are not in a position to agree at the same time on the type, quality and quantity of the goods to be shipped in the two directions.

6. Another factor to be considered is the possible reluctance of a party to ship the goods before being certain that the other party will ship goods. Payment against the presentation of shipping documents or the opening of a documentary letter of credit, devices used with other types of contracts to address such a concern, cannot be used in barter since neither delivery is payable in money. Simultaneous deliveries, which might be a solution to take care of this kind of concern, are seldom feasible in international commerce. As a result, a party may delay shipping until the other party has shipped because of a concern that the other party might not ship. Such a delay may cause an inconvenience to both parties: to the party that has planned to deliver the goods at the agreed time and is burdened with the possession of the goods and to the party who does not receive the goods in time. The parties may overcome these concerns by providing for a guarantee or a stand-by letter of credit to assure the party who has shipped of compensation in the event that the other party fails to ship (the use of guarantees or stand-by letters of credit for this purpose is discussed in chapter XII, "Security for performance", paragraphs 38 and 45).

7. A further consideration is that under a barter contract the value of the goods to be shipped in one direction is often measured by the goods to be shipped in the other direction, rather than in terms of the market price for each shipment. The absence of a price in a barter contract or the use of prices that do not reflect the market prices might cause a difficulty when non-conforming goods are delivered under a barter contract. If in such a case monetary compensation is regarded as the appropriate relief, the absence in the contract of a market price, or of any price at all, could lead to disagreement over the amount of the compensation. The stipulation of a price other than the market price may also give rise to a difficulty in calculating customs duties when they are based on the market value of the goods.

#### (b) Merged contract

8. The term "merged contract" is used to describe the case in which the parties embody in one contract all the terms covering the obligations of the parties to ship goods to each other and to pay for the goods they have received. If the parties agree to set off their claims for payment under a merged contract, the difference between a merged contract and a barter contract, under which one shipment constitutes compensation for the other shipment, would be diminished. As in barter, there is no need in a merged contract for a countertrade commitment since the deliveries to be made in the two directions are covered by definite contract terms.

9. Many legal systems appear to give weight to the contract structure of the transaction in determining whether the obligations are interdependent. In such systems, if the mutual obligations are merged into one contract, the mutual obligations are likely to be considered as interdependent so that non-delivery, refusal to take delivery, or non-payment relating to a shipment in one direction may be invoked as a reason for suspending or refusing performance in the other direction. Furthermore, termination of an obligation in one direction, whether or not a

party is responsible for the termination, may be interpreted as entitling a party to terminate an obligation in the other direction. If the parties using a merged contract approach wish to keep the obligation to ship goods in one direction and the corresponding payment obligation independent from the obligations relating to the shipment in the other direction, they should use unambiguous language to that effect. Further discussion on the question of interdependence of obligations is found in chapter XIII.

## 2. Separate contracts

10. When the parties use separate contracts for the shipments in the two directions, they would use one of the following approaches: (a) the export contract and the countertrade agreement are concluded simultaneously and the counter-export contract is concluded subsequently; (b) the countertrade agreement is concluded prior to the conclusion of any definite supply contracts; and (c) the separate supply contracts for the shipment in each direction and the countertrade agreement establishing a relationship between them are concluded simultaneously.

11. The obligation to ship goods in a particular direction in a countertrade transaction may be fulfilled by two or more different contracts, which may involve different buyers and sellers. While such a situation affects the contractual structure of a given transaction, it does not affect the nature of the discussion in this chapter. Therefore, references in the singular to a supply contract, as well as to an export or counter-export contract, also cover the situation in which more than one contract is concluded for the shipment of goods in a particular direction.

### (a) *Export contract and countertrade agreement concluded simultaneously*

12. The parties often finalize a contract for the shipment in one direction (export contract) before they are able to reach agreement on the contract for the shipment in the other direction (counter-export contract). Parties using this contracting approach may face a broad range of issues specific to countertrade. In order to assure conclusion of the counter-export contract, the parties conclude, simultaneously with the conclusion of the export contract, a countertrade agreement containing the commitment to conclude the counter-export contract. The primary purpose of the countertrade agreement in such cases is, in addition to stating the countertrade commitment, to outline the terms of the future contract and establish procedures for concluding and carrying out supply contracts. Possible issues to be addressed in such a countertrade agreement are enumerated below in paragraphs 22 to 33.

13. The contents of the countertrade agreement would be influenced by the degree to which the parties are able to define the terms of the future contract. It is advisable that the countertrade agreement be as definite as possible concerning the terms of the future contract, in particular regarding the type, quality, quantity and price of the countertrade goods, in order to increase the likelihood that the countertrade commitment will be fulfilled. To the extent that the parties are not in a position to settle the

terms of the counter-export contract in the countertrade agreement, they are advised to establish guidelines within which the terms are to be agreed upon and procedures for negotiation (for the discussion on negotiation procedures and on definiteness of the countertrade commitment see below, paragraphs 39 to 61).

14. The content of the countertrade agreement would also be influenced by the degree of interest the parties have in the shipments in the two directions. In many cases the exporter is primarily interested in the conclusion of the export contract, and the countertrade commitment results primarily from a desire to secure the export contract. In other cases, the importer purchases goods from the exporter in order to enable the exporter to finance the counter-import. In yet other cases, each side is particularly interested in obtaining the goods being offered by the other side. Because the interests of the parties vary in such a manner, the content of the countertrade agreement may vary from case to case with respect to issues such as sanctions for non-fulfilment of the countertrade commitment, payment mechanisms, procedures for concluding the future contract and for monitoring fulfilment of the countertrade commitment, and interdependence of obligations.

15. The simultaneous conclusion of an export contract and a countertrade agreement is an approach frequently used in counter-purchase, buy-back or offset transactions. In the case of the counter-purchase transaction, the parties may not yet know what type of goods would be counter-exported. In the case of a buy-back, the parties may not be able to agree on such terms as price or quantity because of the long time period between the conclusion of the contract for the export of the production facility and the beginning of production of resultant products. In an offset transaction, the parties may not know what type of goods will be counter-exported or the identity of the counter-exporters.

16. The use of this contracting approach raises the question whether to include the terms of the countertrade agreement in the export contract or to embody those terms in a separate instrument. The choice of the parties in this regard may have an effect on the degree to which the obligations stipulated in the export contract and the obligations set forth in the countertrade agreement are considered to be interdependent. When there is such interdependence, a delay in the fulfilment or non-fulfilment of the countertrade commitment may provide the importer with a justification for suspending payment of the amounts due under the export contract or for deducting corresponding damages from the payment due under the export contract. Similarly, the exporter may regard a delay in payment for the export contract as a ground for delaying fulfilment of the countertrade commitment. Furthermore, delayed payment under the counter-export contract might prompt the importer to delay payment under the export contract.

17. If the obligations relating to the export and to the countertrade commitment are embodied in separate contracts, it appears that many legal systems would consider the two sets of obligations to be independent, except to the

extent specific contract provisions establish interdependence. In other legal systems the export contract and the countertrade agreement may, despite the use of separate contracts, be considered to be interdependent on the ground that the obligations of the parties embodied in the two contracts form part of a single transaction. When the parties wish to avoid interdependence of obligations between the export contract and the countertrade agreement, or when they wish to limit interdependence to particular obligations, it is advisable that they embody the export contract and the countertrade agreement in separate contracts. When, despite the use of separate contracts, it is uncertain whether the obligations under the export contract and the countertrade agreement would be considered independent, it is advisable that the independence of the obligations be clearly expressed in the countertrade agreement.

18. The parties may wish to establish, by express contract clauses, an interrelationship between particular obligations arising out of the export contract and out of the countertrade agreement, while keeping other obligations independent. The parties may, for example, agree that refusal to take delivery under the export contract or termination of the export contract permits the exporter to terminate the countertrade agreement, and that non-fulfilment of the countertrade commitment by the counter-importer entitles the counter-exporter to deduct an agreed amount as liquidated damages or penalty from payments due under the export contract. Further discussion on the question of interdependence is found in chapter XIII.

*(b) Countertrade agreement concluded prior to conclusion of definite supply contracts*

19. The conclusion of a countertrade agreement may be the first step in the transaction prior to the conclusion of any definite supply contracts in either direction. The aim of the countertrade agreement in such a case is to express the commitment of the parties to conclude supply contracts in the two directions and to establish procedures for concluding and implementing those contracts. In order to achieve the envisaged level of shipments in the two directions, it is advisable that the countertrade agreement be as definite as possible concerning the terms of the contracts to be concluded in the two directions (for a discussion on negotiation procedures and on definiteness of the countertrade agreement see below, paragraphs 39 to 61). The parties may also wish to establish mechanisms for monitoring and recording the level of trade and to provide sanctions for a failure to fulfil the countertrade commitment. The need for such sanctions may be diminished if the parties agree that their countervailing claims for payment for the shipments in each direction will be set off rather than paid for individually (see chapter IX, "Payment", paragraphs \_\_\_\_ to \_\_\_\_). Such a payment mechanism would provide an incentive to both parties to order goods from each other and thereby attain the level of trade envisaged in the countertrade agreement. The incentive is derived from the fact that a party who has shipped goods and holds a trade surplus will be stimulated to order goods from the other party in order to be compensated for its own deliveries. These and other issues that the parties may wish to address in a countertrade agreement entered into

prior to the conclusion of any supply contract are set out below in paragraphs 22 to 33.

*(c) Export contract, counter-export contract and countertrade agreement concluded simultaneously*

20. When the parties simultaneously conclude a contract for the supply of goods in one direction and another contract for the supply of goods in the other direction, and there is no indication in the contracts that there is a relationship between them, the contracts would appear on their face to be independent of one another even if one party or both parties regarded the conclusion of one contract as a condition for the conclusion of the other contract. When, however, the parties wish to give contractual effect to an intention that the conclusion of one contract be conditioned upon the conclusion of the other, i.e. when they wish to structure the contracts in the two directions as a countertrade transaction, the parties should conclude a countertrade agreement expressing that relationship.

21. This contracting approach raises a limited number of issues since it does not involve a countertrade commitment. The main issue in this contracting approach is the manner in which the obligations of the parties with respect to the shipments in the two directions are to be linked by provisions in the countertrade agreement. There is no need to deal in the countertrade agreement with various issues related to the fulfilment of the countertrade commitment (in particular the type, quality, quantity or price of the countertrade goods, time schedules of fulfilment of countertrade commitment, security of performance or liquidated damages or penalties supporting the countertrade commitment). The issues that the parties may wish to address in a countertrade agreement concluded simultaneously with the definite supply contracts in the two directions are set out below in paragraphs 34 to 36.

## **B. Contents of countertrade agreement**

### **1. Countertrade agreement with countertrade commitment**

22. *Countertrade commitment.* The essential feature of a countertrade commitment is a stipulation by which the parties undertake to negotiate in order to conclude one or more supply contracts. In order to add definiteness to the commitment and to increase the likelihood of its fulfilment, parties often include in the countertrade agreement provisions concerning terms of the anticipated contract, negotiation procedures designed to facilitate fulfilment of the countertrade commitment, sanctions for the failure to conclude the contract, and other provisions to ensure the proper carrying out of the countertrade transaction. Negotiation procedures and means for providing definiteness to the commitment are discussed in paragraphs 37 to 61. Other types of clauses that parties may wish to consider including in a countertrade agreement are enumerated below (paragraphs 23 to 33) and elaborated in the following chapters of the legal guide.

23. *Type, quality and quantity of goods.* In order for the countertrade commitment to be meaningful, it is particu-



larly important that the countertrade agreement be as specific as possible as to the type, quality and quantity of the countertrade goods. Clauses in the countertrade agreement addressing these issues are discussed in chapter V.

24. *Pricing of goods.* Since the parties are often not in a position to set the price of the countertrade goods at the time the countertrade agreement is concluded, they may establish guidelines and procedures for setting the price at a later date. Such provisions help to prevent delays in the conclusion of supply contracts and provide pricing flexibility in long-term countertrade transactions. Issues relating to pricing clauses are addressed in chapter VI.

25. *Fulfilment of countertrade commitment.* A basic question to be addressed in the countertrade agreement is the length of time to be allowed for fulfilment of the countertrade commitment. In some cases, the parties establish mechanisms for monitoring and recording fulfilment of the countertrade commitment. Chapter VII discusses provisions relating both to the length of the fulfilment period and to monitoring and recording mechanisms.

26. *Participation of third persons.* The parties may wish to involve third persons, either as suppliers or purchasers, or both, of countertrade goods. In such cases the countertrade agreement may contain provisions concerning participation by third persons. Those provisions could determine the manner in which the third persons would be selected and the legal effect of the involvement of third persons on the obligations undertaken by the parties to the countertrade agreement. Issues to be dealt with in the countertrade agreement relating to participation of third persons are discussed in chapter VIII.

27. *Payment.* When payments for the shipments in each direction are kept independent, no payment issues specific to countertrade are raised. However, when the parties wish to link the payments for the shipments in the two directions so that the proceeds of the contract in one direction are used to pay for the contract in the other direction, they would have to include in the countertrade agreement provisions on the manner in which payment is to be linked. A discussion of contractual aspects of various types of linked payment mechanisms is found in chapter IX.

28. *Restrictions on resale of goods.* The freedom of a party to resell goods purchased in a countertrade transaction may sometimes be restricted by contractual agreement between the supplier and the purchaser of the goods. The purchaser may be restricted as to the territory of resale, as well as to the terms of resale (e.g., resale price or packaging). Clauses in the countertrade agreement concerning such restrictions are discussed in chapter X.

29. *Liquidated damages and penalties.* In order to limit disagreements as to the extent of damages resulting from a breach of the countertrade commitment, the countertrade agreement may stipulate a sum of money due from a party upon failure to fulfil the commitment to purchase or make available countertrade goods. The use of such clauses in a countertrade agreement is addressed in chapter XI.

30. *Security for performance.* The parties may use guarantees to support fulfilment of the countertrade commitment, as well as the proper performance of individual supply contracts concluded pursuant to the countertrade commitment. The use of guarantees to support the fulfilment of the countertrade commitment, or the obligation to pay under a liquidated damages or penalty clause, raises issues to be addressed in the countertrade agreement. In transactions in which the parties limit payments in cash by exchanging goods for goods or setting off countervailing payment claims, the countertrade agreement may stipulate the use of guarantees to cover liquidation of an imbalance in the flow of trade. Issues to be addressed in the countertrade agreement when the parties wish to use guarantees to support fulfilment of the countertrade commitment and liquidation of an imbalance in trade are discussed in chapter XII.

31. *Interdependence of obligations.* The parties may wish to address in the countertrade agreement the question of the interdependence of their obligations pertaining to the shipments in one direction with their obligations pertaining to the shipment in the other direction. This question becomes relevant when a difficulty arises in the conclusion or performance of a supply contract. Provisions of this type are examined in chapter XIII.

32. *Choice of law.* The parties may wish to agree upon the law to be applied to the countertrade agreement or to the supply contracts. Provisions of this nature are discussed in chapter XIV.

33. *Settlement of disputes.* Chapter XV examines issues to be considered in preparing dispute settlement clauses for countertrade agreements.

## 2. Countertrade agreement without countertrade commitment

34. When the parties simultaneously conclude separate contracts for the entire supply of goods in the two directions, there is no need for a countertrade agreement containing either a countertrade commitment to conclude future contracts, or clauses on the type, quality, quantity or price of the goods, liquidated damages or penalties to be paid for failure to conclude supply contracts, or guarantees to support the countertrade commitment.

35. The primary purpose of the countertrade agreement in this case would be to establish a link between the contracts in the two directions, namely, that the conclusion of a contract in one direction is conditioned upon the conclusion of a contract in the other direction. The countertrade agreement may provide that a problem in the performance of one contract would have an effect on the obligation to perform the contractual obligations in the other direction (clauses establishing a link of this type are discussed in chapter XIII). The parties may also establish a link between the contracts by structuring payment for the two contracts in such a way that the proceeds of the shipment in one direction would be used to pay for the shipment in the other direction. Linked payment mechanisms of this type are discussed in chapter IX.

36. In addition, the countertrade agreement may address issues such as restrictions on the resale of countertrade goods (chapter X), participation of third persons in the countertrade transaction (chapter VIII), choice of law (chapter XIV) and settlement of disputes (chapter XV).

### C. Countertrade commitment

37. The degree to which the parties commit themselves to enter into a supply contract may range from a commitment to exercise "best efforts" to conclude a supply contract to a firm commitment to enter into a supply contract. Under a "best efforts" commitment, also referred to as "serious intention", the commitment of the parties is limited to negotiating in good faith, and the parties retain the discretion to refuse all contract offers that they consider unacceptable.

38. If the parties wish to increase the likelihood that a supply contract will be concluded, they should include in the countertrade agreement procedures to be followed in their negotiations (see paragraphs 39 to 42, below) and clauses setting out, as definitely as possible, the terms of the future contract (paragraphs 43 to 61).

#### 1. Negotiation procedures

39. Countertrade agreements may set forth with varying degrees of procedural detail the manner in which negotiations are to be carried out. Specifying the negotiation procedures increases the probability that the negotiations will lead to a successful outcome. This would be particularly true where the nature of the negotiations is likely to be complicated, either because of the subject matter of the eventual contracts or because of the number of persons who might be involved in those negotiations.

40. At a minimum, the countertrade agreement might provide that a party would be obligated to respond to contract proposals by the other party. More specific procedures would address issues such as: the party who is to submit a contract offer; questions to be covered by a contract offer; time periods for submitting it; the form, means or frequency of communication; the time period for reply; the time within which an agreement must be reached, and beyond which negotiations will be deemed to have failed. Furthermore, the parties may provide that in certain circumstances a party would be relieved of the duty to negotiate (e.g., when that party has made an offer meeting the agreed conditions and it has not been accepted, or, if the other party was to make the offer, when no such offer has been made).

41. The stipulation of negotiation procedures such as those mentioned in the previous paragraph may also increase the possibility that a party who has not negotiated in good faith could be held responsible for the failure to conclude a contract. Such procedures could enable an aggrieved party to demonstrate, for example, that the other party refused to negotiate, imposed conditions to negotiate that the party could not properly impose, used unfair dilatory tactics, reopened discussion on issues already

agreed upon, negotiated with other parties when it was improper to do so, or prematurely broke off negotiations.

42. However, procedural stipulations alone do not ensure that negotiations will be successful or that a party interested in the conclusion of the contract will be able to obtain relief in the event the negotiations do not succeed. A party who refuses to enter into a contract can avoid liability by showing adherence to the negotiation procedures. The most effective way to increase the likelihood of succeeding in the negotiations and of having a basis for obtaining relief in the event the negotiations fail, would be to increase the definiteness of the countertrade commitment. This would be done by stipulating in the countertrade agreement, to the degree possible, the terms of the future contract.

#### 2. Providing definiteness to countertrade commitment

##### (a) General remarks

43. Commitments to enter into supply contracts often do not stipulate in a definite manner the terms of the contracts to be concluded. Frequently the parties do not know the type of goods that will be the subject of the future supply contracts or what the terms of delivery will be. Even if the parties might be able to set out in the countertrade agreement terms of the future supply contract, they sometimes forego doing so because they expect each party to live up to the commitment to conclude a future contract, though the terms of that contract may not be defined in great detail in the countertrade agreement.

44. A lack of definiteness may result in delays or uncertainties in negotiating a supply contract in view of the potentially broad scope of the negotiations. Furthermore, it may be difficult to establish whether a party who has refused a contract offer is in breach of the countertrade commitment.

45. Sometimes the parties are not in a position to be more definite about the terms of the anticipated supply contract than to provide that the contract terms should be fair or in accordance with the prevailing market conditions. Such provisions may be helpful when countertrade goods of a standard quality are agreed upon, thereby enabling a fair price to be ascertained. If, however, the type of countertrade goods is not settled or if the countertrade goods are products that do not have a standard price, such a "fair terms" commitment may not substantially enhance the position of the party interested in the conclusion of the contract. In such cases opinions may differ as to what contract terms are fair, thereby protracting the negotiations and making uncertain the success of a claim against the party refusing to conclude the contract.

46. Terms of a future supply contract may be specified in the countertrade agreement, or the countertrade agreement may provide guidelines for settling terms of the future contract. As the countertrade agreement becomes more definite with respect to the terms essential for the existence of an enforceable contract, the agreement approaches the point at which the parties have settled all the

terms of the supply contract and postponed only the act of signing the contract.

47. Many legal systems contain rules to which the parties may resort in order to provide definiteness to a contract clause. For example, numerous legal systems provide a solution when the parties have not settled the price of the goods; the solution may be, for instance, that the price should be the one "generally charged at the time of the conclusion of the contract for such goods sold under comparable circumstances in the trade concerned" (article 55 of the United Nations Convention on Contracts for the International Sale of Goods). Another example may be the rule on the quality of the goods to be delivered under the contract when the contract has not settled that issue; the rule in article 35(2)(a) of the above-mentioned Convention is that the goods should be "fit for the purposes for which goods of the same description would ordinarily be used". In some legal systems the parties may, within certain limits, resort to a court for the purpose of determining such a contract element. In other legal systems, however, the courts are not competent to intervene in this manner in a contractual relationship.

48. Although such means for contract supplementation exist in many legal systems, they normally do not provide a solution in all cases of indefiniteness. The contract elements left indefinite in the countertrade agreement may not lend themselves to being made definite by reference to the applicable law. For example, if the parties have not agreed on the type of goods to be counter-exported, it would probably be impossible to determine the type on the basis of the applicable law. Where the type of goods has been settled, the criteria provided in the applicable law concerning the price of the goods may not lead to a clear solution. Furthermore, such contract supplementation is subject to uncertainty arising out of divergencies among legal systems as to the techniques of supplementation, the role of the courts, the arbitral tribunal, or the parties in determining the missing term, or as to the judicial control over the result of the supplementation. In any case, reliance on such means for contract supplementation tends to be more useful for purposes of dispute resolution than it is for contract implementation. As a result, the parties may wish to consider the contractual means discussed below for providing definiteness to a contract term left open in the countertrade agreement.

*(b) Contractual means of providing definiteness*

49. The terms that are often left indefinite in the countertrade agreement and with respect to which contractual means for completing indefinite terms may be particularly useful are the type, quality, price and quantity of the countertrade goods. The contractual means that the parties may consider for completing any one or more of those terms are discussed in a general manner in subsections (i) through (iii) below. In other parts of the legal guide, these contractual means will be referred to in specific contexts.

*(i) Standards or guidelines*

50. The parties may wish to provide standards or guidelines to be used in determining particular contract terms.

The use of a standard would allow the parties to determine a contract term by computation or by some other objective method not dependent upon the discretion of the parties. Examples of such standards include a formula, tariff, quotation, rate, index, statistic, or some other criterion not influenced by the will of either party. For example, the price of the countertrade goods may be determined by reference to the price at which goods of the same type are sold in a particular market or exchange, or the quality of the countertrade goods may be defined by reference to a particular national or international quality standard. Many legal systems recognize as valid a provision that the price or other contract term should be determined by reference to a standard.

51. Guidelines, on the other hand, set parameters within which a contract term is to be determined and involve a degree of latitude in arriving at a contract term. For example, the countertrade agreement may set a range within which the parties are to negotiate the price or it may be agreed that the price must be "reasonable". If the type of goods has not been determined, the parties may agree on a list of goods on which the negotiations should focus or to which it should be limited (such lists are discussed in chapter V, "Type, quality and quantity of goods"). As to other terms of the future contract, such as delivery, the parties may agree that the supply contract should be negotiated on the basis of prevailing market conditions. Where reference is made to market conditions, it is advisable that the parties refer to a specific market.

52. Because of the discretion left to the parties, the inclusion of a guideline in the countertrade agreement for a particular term in the future contract does not ensure the finalization of that term. Nevertheless, a narrow range within which agreement should have been achieved, or clear guidelines limiting the latitude available to the negotiators, will not only make it more likely that a contract will be concluded but will also make it easier to show that a party refusing a given contract offer is in breach of the countertrade commitment.

*(ii) Determination of contract term by third person*

53. Sometimes the parties agree that a particular contract term will be determined by a third person. While such an approach provides a high degree of certainty that the term will be made definite, its infrequent use may be attributable to a reluctance by parties to relinquish their control over a contract term. When such a method is used, it is usually to determine the price of goods (see chapter VI, paragraphs \_\_\_\_ to \_\_\_\_). The parties might be willing to agree on such a method of determining a contract term if clear guidelines are established within which the third person is to decide or if the third-person intervention is the last resort after other agreed mechanisms (e.g., negotiation, application of an agreed standard) have failed. If the parties do not wish to entrust the decision on a contract term to a third person, but still want the benefit of the opinion of a third person, it may be agreed that the determination by the third person will only be a recommendation.

54. A number of legal systems recognize the right of the parties to entrust a third person with determining a con-

tract term. In particular, reference by the parties to a third person for the determination of the price is a question frequently addressed in legal systems. There are, however, variations among the systems. For example, while some legal systems recognize that an arbitral tribunal or even a court may be entrusted with the determination of a contract term, others permit such a determination only if it is not performed as part of arbitral or judicial proceedings. Legal systems also differ as to the consequences of a failure by the parties to agree on the third person or of a failure by the third person to act. Under some legal systems, the parties would have no recourse to a procedure for designating or replacing the person, and would have to accept the consequences of the contract term being left undetermined. In other systems, if the third person was to determine the price, the case may be treated as if the parties had agreed on a reasonable price. There are also differing approaches to the availability and extent of judicial review of a decision by a third person.

55. The issues that the parties may wish to address in a stipulation empowering a third person to determine a contract term are enumerated below.

56. *Person to request determination of term.* The parties may wish to address the question whether, at the time when the parties fail to agree on the term, either party would be entitled to request the third person to determine the term or whether the third person may act only upon the request of both parties.

57. *The identity of the third person or the appointment procedure.* The parties may wish to name in the countertrade agreement the person who is to determine the contract term. In this case, the parties may also wish to provide an appointment procedure to be used in the event that the named person fails to act or is unable to act. If the parties do not wish to name the person who is to determine the contract term, it may be advisable for the parties to agree that they will appoint the third person at such time as they are unable themselves to reach agreement on the contract term. In such a case the parties may wish to agree on an appointment procedure, which is to become operative if the parties cannot reach agreement on the appointment of the third person.

58. *Guidelines or standards to be observed by third person.* The parties are advised to delimit the mandate of the

third person by providing guidelines or standards to be observed in determining the contract term. Such guidelines and standards are discussed generally above, paragraphs 50 to 52, and, as to price, in chapter VI, "Pricing of goods", paragraphs \_\_\_\_\_ to \_\_\_\_\_.

59. *Nature of decision of third person.* The parties may agree that the decision by the third person would be binding as a contractual stipulation of the parties. Another approach may be to provide that the determination of the third person would be treated as a recommendation to be considered by the parties in good faith.

60. *Procedure for challenging decision by the third person.* In some situations, for example, where the binding determination by the third person involves a question of particular economic significance, the parties might wish to provide an opportunity for the decision to be challenged by resort to another person, a panel of persons, or an institution. As to the nature of the decision on the challenge, it may be provided that the decision would bind the parties or only be a recommendation. The parties may wish to stipulate the mandate that would be given to the person deciding on the challenge (i.e., to uphold or reject the challenge, or to modify the challenged decision). The parties may wish to indicate how, in the event the challenged decision is set aside, the decision on the contract term is to be made (e.g., by the parties themselves or by the same or a different third person).

(iii) *Determination of contract term by contract party*

61. Sometimes the countertrade agreement leaves the determination of a contract term to one of the parties to the countertrade agreement. If such an approach is contemplated, the parties should take into account the restrictions legal systems provide concerning the validity of clauses empowering a party to the contract to determine a term of the contract. Generally, an arbitrary right given to one of the parties to determine a contract term is unenforceable. If the subject of the determination is the price, a number of systems would recognize such a right given to a party if its exercise is limited by such standards as reasonableness, good faith or fairness. Some of these systems would construe ambiguous agreements as implying a reference to such a standard. Other legal systems require the freedom to determine the price to be limited by a more definite standard.

[A/CN.9/332/Add.3]

#### CHAPTER IV. GENERAL REMARKS ON DRAFTING

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## A. General remarks

1. A countertrade transaction is usually the result of extensive written and oral communications between the parties. Each party may find it desirable to establish a checklist of the necessary steps to be taken in negotiating and drawing up contracts constituting the transaction (the countertrade agreement and the supply contracts). Such a checklist could reduce the possibility of omissions or errors occurring in the steps taken prior to entering into the contract. A party may also wish to consider seeking legal or technical advice in drawing up the contracts. While countertrade transactions can be expected to become routine for parties experienced in countertrade, even simple countertrade transactions may pose difficulties for newcomers to countertrade calling for legal or technical advice. For complex transactions, even experienced parties may require advice.

2. The process of establishing a countertrade transaction could be facilitated if the parties agree that, before a first draft of the countertrade agreement and any supply contract is prepared, negotiations on the main technical and commercial issues are to take place. Thereafter, one of the parties could be asked to submit a first draft reflecting the agreement reached during the negotiations. A first draft may then be discussed and elaborated, resulting in a preliminary set of contract documents, which, after review and finalization, will govern the relationship between the parties.

3. The legal rules applicable to the countertrade agreement may require that a countertrade agreement be in written form. Even when written form is not required, it is advisable for the parties to express their agreement in writing to avoid later disputes as to what terms were actually agreed upon. If the parties decide that modifications of the countertrade agreement are to be in writing, it is advisable that this be stated in the countertrade agreement.

4. The parties may wish to clarify the relationship between the contract documents, on the one hand, and the oral exchanges, correspondence and draft documents which came about during the negotiations, on the other. The parties may wish to provide that those communications and draft documents are not part of the contract. They may further provide that those communications and draft documents cannot be used to interpret the contract, or, alternatively, that they may be used for this purpose to the extent permitted by the applicable law. Under the law applicable to the contract, oral exchanges and correspondence might in some cases be relevant to the interpretation of the contract even if they occur after the contract is entered into.

5. The parties should ensure that the contract terms as expressed in writing are unambiguous and will not give rise to disputes, and that the relationship between the various documents comprising the transaction is clearly established. Such precision may be of particular importance in countertrade transactions that are carried out over a long period and may have to be administered by persons

who have not participated in the negotiations at the outset of the transaction (e.g. buy-back or offset transactions). Each party may find it useful to designate one person to be primarily responsible for supervising the preparation of the contract documents. It is advisable for that person to be a skilled draftsman familiar with international countertrade transactions. To the extent possible, it is advisable for that person to be present during important negotiations. Each party may find it useful to have the final contract documents scrutinized by a team having expertise in the subject-matter reflected in the documents in order to ensure accuracy and consistency of style and content.

6. The applicable legal rules may also contain rules on the interpretation of contracts and presumptions as to the meaning of certain expressions such as "reasonable price" (chapter VI, "Pricing of goods", paragraph 24), "trust" and "*compte fiduciaire*" (chapter IX, "Payment", paragraph 16), and "penalty" (chapter XI, "Liquidated damages and penalties", paragraph \_\_\_\_). The parties are advised to select contract wording in light of the applicable law in order to ensure that the expressions used reflect the intended meaning. One approach is for the applicable law to be determined at a very early stage of the relationship between the parties (e.g., at the commencement of negotiations). The countertrade transaction may then be negotiated and drawn up taking that law into account. Another approach is for the parties to determine the applicable law only after negotiations have taken place on the main technical and commercial issues and have resulted in a measure of accord between the parties. They may thereafter review the first drafts relating to the transaction, which reflect that accord, in the light of the applicable law to ensure that the terms of the draft take account of that law.

7. The parties should take into account the mandatory legal rules of an administrative, fiscal or other public nature in the country of each party that are relevant to the countertrade transaction. They should also take into account such mandatory legal rules in other countries when those rules are relevant to the transaction. Certain rules may concern the technical aspects of the countertrade agreement (e.g., safety standards for the countertrade goods or rules relating to environmental protection), and the terms of the countertrade agreement should not conflict with those rules. Other rules may concern export, import and foreign exchange restrictions (e.g., it may be provided that certain rights and obligations are not to arise until export or import licences, approvals for payments or for the use of particular payment mechanisms have been granted). Legal rules relating to taxation may be a factor, and the parties may wish to include in the countertrade agreement provisions dealing with liability for tax.

8. The parties may wish to consider whether the countertrade agreement is to contain introductory recitals. The recitals may set forth representations made by one or both parties which induced the parties to enter into the agreement. The recitals may also describe the context in which the countertrade agreement was entered into. The extent to which recitals are used in the interpretation of the terms of the agreement introduced by the recitals varies under

different legal systems, and their impact on the interpretation may be uncertain. Accordingly, if the contents of recitals are intended to be significant in the interpretation or implementation of the countertrade agreement, it may be preferable to include those contents in the operative provisions of the countertrade agreement.

9. The parties may find it useful to examine standard forms of countertrade agreements, general conditions, standard clauses, or previously concluded countertrade agreements to facilitate the preparation of contract documents. Such an examination may clarify for the parties the issues that should be addressed in their negotiations. However, it is inadvisable to adopt provisions appearing in those documents without critical examination. Those provisions may, as a whole, reflect an undesirable balance of interests, or those provisions may not accurately reflect the terms agreed to by the parties. The parties may find it advisable to compare the approaches adopted in the forms, conditions or countertrade agreements examined by them with the approaches recommended in the present legal guide.

### B. Language

10. The contracts constituting the countertrade transaction (i.e., the countertrade agreement and the individual supply contracts) may all be drawn up in only one language version (which may, but need not be, the language of either of the parties), or in the two languages of the parties where those languages differ, or the countertrade agreement may be drawn up in one language and the supply contracts in another language. Where the conclusion of the countertrade agreement precedes the conclusion of the supply contracts in the two directions (chapter III, "Contracting approach", paragraph 19), or where it precedes the conclusion of the counter-export contract (chapter III, paragraphs 12 to 18), it is advisable that the countertrade agreement specify the language of the contracts. The specification of the language before the commencement of negotiations on a supply contract may facilitate preparations of the parties for the negotiations and avoid a disagreement.

11. Drawing up a contract in only one language version will reduce conflicts of interpretation in regard to its provisions. Drawing up all the contracts constituting the countertrade transaction in the same language will reduce conflicts between two contracts of related content. On the other hand, each party may understand its rights and obligations more easily if one version of the contract is in its language. In addition, where extensive or complex working instructions to personnel of one or both parties are derived directly from the contract, it may be of particular importance that the contract is in the language in which the instructions are to be given. If only one language is to be used, the parties may wish to take the following factors into account in choosing that language: that it is advisable for the language chosen to be understood by the senior personnel of each party who will be implementing the contract; that it might be advisable for the contract to be in a language commonly used in international commerce; that the settlement of disputes is likely to be facilitated if the language chosen is the lan-

guage in which proceedings would be conducted or if the language chosen is the language or one of the languages of the country of the applicable law.

12. If the parties do not draw up the contracts in a single language version, it is advisable to specify in the contracts which language version is to prevail in the event of a conflict between the two versions. For example, if the negotiations were conducted in one of the languages, the parties may wish to provide that the version in the language of the negotiations is to prevail. A provision that one of the language versions is to prevail might induce both parties to clarify as far as possible the prevailing language version. The parties may wish one language version to prevail in respect of certain segments of the transaction or in respect of certain contract documents (e.g. countertrade agreement or technical documents related to the countertrade agreement or a supply contract) and another language version in respect of the remainder of the contracts or documents. Where the parties provide that both language versions are to have equal status, the parties should attempt to provide guidelines for the settlement of a conflict between the two language versions. The parties may provide, for example, that the agreement is to be interpreted according to practices that the parties have established between themselves and usages regularly observed in international trade with respect to the agreement in question. The parties may also wish to provide that where a term of the contract in one language version is unclear, the corresponding term in the other language version may be used to clarify that term.

### C. Parties to transaction

13. Where a contract involved in the transaction (the countertrade agreement or a supply contract) consists of several documents, the parties may wish to identify and describe themselves in a principal document designed to come first in logical sequence among the documents that incorporate that contract. The document should set forth, in a legally accurate form, the names of the parties, indicate their addresses, record the fact that the parties have entered into a contract, briefly describe the subject-matter of the contract, and be signed by the parties. It should also set forth the date on which, and the place where, the contract was signed, and the time when it is to enter into force. Subsequent reference in the contract to the parties may be facilitated if the principal document would specify that in the subsequent text and in the subordinate documents the parties would be referred to by agreed abbreviations or by expressions such as exporter, importer, counter-exporter, counter-importer, trading house. A party may have several addresses (e.g., the address of its head office, the address of a branch through which the contract was negotiated) and it may be preferable to specify in the document the address to which notifications directed to a party should be sent.

14. Parties to countertrade transactions are usually legal entities. In such cases the source of their legal status (e.g. incorporation under the laws of a particular country) may be set out in the contract. There may be limitations on the capacity of legal entities to enter into contracts. Therefore,

unless satisfied of the other party's capacity to enter into the contract, each party may wish to require from the other some proof of that capacity. If a party to the contract is a legal entity, the other party may wish to satisfy itself that the official of the entity signing the contract has the authority to bind the entity. If the contract is entered into by an agent on behalf of a principal, the name, address and status of the agent and of the principal may be identified, and evidence of authority from the principal enabling the agent to enter into the contract on its behalf may be annexed.

#### D. Notifications

15. In a countertrade transaction a party frequently has to notify the other party of certain events or situations. Such notifications may be required, for example, to initiate negotiations for the conclusion of a supply contract, to facilitate cooperation in the performance of the contract, to enable the party to whom notification is given to take action, as the prerequisite to the exercise of a right, or as the means of exercising a right. The parties may wish to address and resolve in their contract certain issues which arise in connection with such notifications.

16. In the interests of certainty, it is desirable to require that all notifications referred to in the countertrade transaction be given in writing, although in certain cases requiring immediate action the parties may wish to provide that notification can be given orally in person or by telephone, to be followed by confirmation in writing. The parties may wish to define "writing" (see paragraph 21 below) and to specify the acceptable means of conveying written notifications (e.g., surface mail, airmail, telex, telegraph, facsimile, electronic data interchange (EDI)). However, care should be taken not to so limit the means of notification that, if the means specified is not available, no valid notification could be given. The parties may also wish to specify the language in which notifications are to be given (e.g., the language of the contract).

17. With regard to the time when a notification is to be effective, two approaches may be considered. One approach is to provide that a notification is effective upon its dispatch by the party giving the notification, or after the lapse of a fixed period of time after the dispatch. Alternatively, the parties may provide that a notice is effective only upon delivery of the notification to the party to whom it is given (see paragraph 21 below). Under the former approach, the risk of a failure to transmit or an error by the transmitting agency in transmission of the notification rests on the party to whom the notification is sent, while under the latter approach it rests on the party dispatching the notification. The parties may find it advantageous to select a means of transmitting the notification which provides proof of the dispatch or delivery, and of the time of dispatch or delivery. Another approach may be to require the party to whom the notification is given to acknowledge receiving the notification. It may be convenient for the contract to contain a general provision to the effect that, unless otherwise specified, one or the other approach with respect to when a notification becomes effective (on dispatch or delivery) is to apply to

notifications referred to in the contract. Exceptions to the general approach adopted may be appropriate for certain notifications.

18. The parties may wish to specify the legal consequences of a failure to notify. The parties may also wish to specify the consequences of a failure to respond to a notification that requires a response. For example, when the parties envisage a series of shipments, they may provide that if the supplier notifies the purchaser of a proposed shipment of a given quantity of the goods on a particular date, the purchaser is deemed to have agreed unless an objection is made.

#### E. Definitions

19. The parties may find it useful to define certain key expressions or concepts that are frequently used in the countertrade agreement or in the supply contract. Definitions are particularly useful in contracts between parties from different countries, even if they use the same language, because of the increased possibility that certain expressions or concepts may be used differently in the two countries. Definitions are also useful when the contracts are in two languages since they tend to reduce the likelihood of errors in translation. A definition ensures that the expression or concept defined is understood in the same sense whenever it is used in the agreement or the contract, and dispenses with the need to clarify the intended meaning of the expression or concept on each occasion that it is used. A definition is advisable if an expression which needs to be used is ambiguous. Such definitions are sometimes made subject to the qualification that the expressions defined bear the meanings assigned to them, "unless the context otherwise requires". Such a qualification takes into account the possibility that an expression which has been defined has inadvertently been used in a context in which it does not bear the meaning assigned to it in the definition. The preferable course is for the parties to scrutinize the contract carefully to ensure that the expressions defined bear the meanings assigned to them wherever they occur, thereby eliminating the need for such a qualification.

20. Since a definition is usually intended to apply throughout an agreement or contract, a list of definitions may be included in the controlling document. Where, however, an expression that needs to be defined is used only in a particular provision or a particular section of the agreement or contract, it may be more convenient to include a definition in the provision or section in question.

21. Expressions such as "countertrade agreement", "writing", "dispatch of notification", and "delivery of notification" may be defined. The parties may wish to consider the following examples:

*Countertrade agreement.* "Countertrade agreement" consists of the following documents, and has that meaning in all the said documents: (a) the present document; (b) list of possible countertrade goods; (c) . . .

*Writing.* "Writing" includes statements contained in a telex, telefax, telegram or other means of telecommunication which provides a record of the content of such statements.

*Dispatch of a notification.* "Dispatch of a notification" by a party occurs when it is properly addressed and conveyed to the appropriate entity for transmission by a mode authorized under the contract.

*Delivery of a notification.* "Delivery of a notification" to a party occurs when it is handed over to that party, or when it is left at an address of that party at which,

under the contract, the notification may be left, irrespective of whether the notification is brought to the attention of the individual responsible to act on the notification.

22. The parties may find it useful, when formulating their own definitions, to consider the descriptions contained in the present guide of the various concepts commonly used in countertrade transactions. Those descriptions can be located by the use of the index to this guide. [Note to the Commission: it is suggested that, after the legal guide has been written, an index should be prepared.]

[A/CN.9/332/Add.4]

## CHAPTER V. TYPE, QUALITY AND QUANTITY OF GOODS

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#### A. General remarks

1. The parties may either identify in the countertrade agreement the type of goods that will be the subject of the future supply contract, possibly stating only broad categories of goods, or not stipulate the type of goods. The more precise the countertrade agreement is with respect to the type of goods, the greater the possibility is of stipulating in the countertrade agreement the quantity and quality of the goods. Precision as to type, quality and quantity increases the likelihood that the intended supply contract will be concluded. Sometimes, even though the type of countertrade goods is identified in the countertrade agreement, the exact quality and quantity of the goods are left for later determination because the conditions on which the parties wish to base their decision on quantity and quality are not yet fully known. This chapter focuses on issues to be dealt with in the countertrade agreement when the parties have not settled all aspects of the type, quality and quantity of the countertrade goods.

#### B. Type of goods

2. Various considerations may enter into the selection of the type of goods. The supplier would prefer that the goods be those that could easily be made available or those that the supplier wishes to introduce in a new market, while the purchaser would like to purchase goods that are needed or could be resold easily. The freedom of the parties to agree on the type of goods to be supplied in one or both directions may be affected by government regulations. For example, in some countries government regulations exclude certain types of goods from being offered for purchase in a countertrade transaction if the price of the goods is not to be remitted as in an ordinary sale. Such regulations are intended to ensure that goods that can be sold for convertible currency are not sold in transactions that restrict the transfer to the supplier of the convertible currency. Government regulations may also provide that the import of certain types of goods is permitted only if the exporter agrees to purchase goods in return.



3. The choice of the parties as to type of goods may also be restricted by government regulations requiring that the countertrade goods must originate in the country, or in a particular region of the country, or must be purchased from a particular economic sector or group of suppliers. Such restrictions on origin and source are particularly likely to be encountered when the party requiring a countertrade commitment is a governmental entity. It is advisable that any restrictions on origin and source of goods be reflected in the countertrade agreement. Clauses in the countertrade agreement concerning origin and source restrictions are discussed in chapter VII, "Fulfilment of countertrade commitment", paragraphs \_\_\_\_ to \_\_\_\_, and chapter VIII, "Participation of third persons", paragraphs \_\_\_\_ to \_\_\_\_.

4. When the parties conclude a countertrade agreement without determining the type of goods, they may wish to include in the countertrade agreement a list of possible countertrade goods, the purchase of which would count toward fulfilment of the countertrade commitment. Where the countertrade agreement is concluded prior to the supply contracts pertaining to deliveries in both directions (chapter III, "Contracting approach", paragraph 19), there may be two lists, one for each direction in which goods will be shipped. The product list may be attached to the countertrade agreement at the time of signature or may be agreed upon later.

5. The countertrade agreement should be clear as to the nature and extent of the undertaking of the parties with respect to a list of possible countertrade goods. The supplier may undertake to make available all the types of goods on the list. In such a case the purchaser would be free to choose from among different types of goods appearing on the list, unless the countertrade agreement restricts the purchaser's choice. For example, there may be a limit on the number of different types of goods that may be purchased or there may be minimum or maximum levels set for the purchase of certain types of goods.

6. The undertaking of the supplier as to availability may be limited to certain specified types of goods on the list. In such a case, the purchaser would be free to choose from among the goods that are identified in the countertrade agreement as being available. The possibility of purchasing any of the other types of goods, whose availability is not assured, would be left to subsequent negotiation.

7. It may be agreed that the purchaser's commitment is to be reduced to the extent the supplier fails to make available those types of goods that are identified in the countertrade agreement as being available (see chapter VII, "Fulfilment of countertrade commitment", paragraph \_\_\_\_). In addition, the supplier's commitment to make available goods appearing on a list may be supported by a liquidated damages or penalty clause (see chapter XI, "Liquidated damages and penalty clauses") or a guarantee (chapter XII, "Security for performance").

8. When the supplier does not make an undertaking as to the availability of any particular type of goods appearing on the list, the determination of the types of goods actually available will occur in the course of the subsequent

negotiations. If the supplier fails to make available any of the goods on the list, the purchaser would not be liable for the failure to fulfil the countertrade commitment (see chapter VII, "Fulfilment of countertrade commitment", paragraph \_\_\_\_).

9. The parties may wish to state in the countertrade agreement that the purchaser is obligated to supply within a specified time period the specifications necessary to establish accurately the purchaser's requirements with respect to the goods to be purchased and to enable the supplier to make a corresponding offer. The countertrade agreement may indicate that specifications will be provided by a third party (e.g., a trading house engaged to purchase the goods, or an end-user).

10. Because countertrade agreements are often entered into for the purpose of developing new exports or new markets for existing exports, selection of the countertrade goods could be conditioned on a requirement that the goods be a non-traditional export of the supplier or, if they are a traditional export, that they be resold in a new market. Where the purchaser has made prior purchases from the supplier or has a prior commitment to purchase goods from the supplier, the countertrade agreement may stipulate that the purchase is to be of a new type of goods and must result in a level of sales higher than established levels in order to be counted towards fulfilment (see also paragraphs 26 and 27 below, concerning "additionality" as a factor in setting the quantity of goods). It is advisable that the countertrade agreement define the requirements as to new products or markets, either by identifying products and markets considered new or identifying those not considered new.

11. Establishing a procedure in the countertrade agreement for making decisions on the type of countertrade goods may be helpful, particularly in a long term countertrade transaction or one involving multiple parties. For example, the parties may wish to form a joint committee that would meet at regular intervals to identify countertrade goods and to monitor fulfilment of the countertrade commitment. Procedures established for identifying countertrade goods should be coordinated with deadlines in the fulfilment schedule. (See chapter VII, "Fulfilment of countertrade commitment", paragraph \_\_\_\_; for a general discussion of negotiation, see chapter III, "Contracting approach", paragraphs 39 to 42). Such a joint committee might also be utilized to settle the price of the goods (see chapter VI, "Pricing of goods", paragraph \_\_\_\_).

### C. Quality of goods

12. The question of quality of countertrade goods raises two main issues that the parties may wish to address in the countertrade agreement. The first involves specifying the level of quality that the goods must meet; the second involves establishing procedures to ascertain, before the conclusion of a supply contract, that goods being offered meet the specified level of quality (pre-contractual inspection). Agreement on both aspects of quality may help the parties to avoid disagreements over such questions as whether the party committed to purchase countertrade

goods is obligated to purchase particular goods offered by the supplier or whether they are worth the price at which they are offered.

### 1. Specifying quality

13. If the type of goods is not identified in the countertrade agreement, or is identified only by broad categories, precise statements of quality cannot be made. In such cases, the parties may only be able to state quality requirements in general terms such as "export", "prime" or "marketable" quality. When the type of goods is identified, it is advisable to be as precise as possible with respect to quality. General statements on quality may be sufficient if the goods are commodities or manufactured goods with standardized levels of quality (e.g., wire, steel sheets or petro-chemical products). Statements of quality can be made more precise, for example, by referring to a particular country or market, to the purpose for which the goods must be fit, or to packaging, safety and environmental requirements.

14. The parties may wish to address in the countertrade agreement the remedies of the purchaser in the event that goods delivered under supply contracts concluded subsequently do not meet quality standards stipulated in the countertrade agreement or in individual supply contracts. By including such provisions in the countertrade agreement, the parties could avoid negotiating the question of the purchaser's remedies each time a supply contract is concluded.

### 2. Pre-contractual quality control

15. This section deals with pre-contractual quality control, i.e., quality control carried out before the conclusion of a supply contract by the party committed to purchase in order to establish whether the goods offered conform to the quality standards set in the countertrade agreement. Pre-contractual quality control allows the parties to avoid difficulties that may arise if, after a supply contract is concluded, the goods are discovered not to meet the agreed quality standards.

#### (a) Identity of inspector

16. The pre-contractual quality control may be conducted by an inspector designated either by the party committed to purchase or by the parties jointly. When the inspector is to be designated jointly, the parties may wish to stipulate in the countertrade agreement criteria for the selection of the inspector. When the type of goods has been identified, the parties would be in a better position to name the inspector since the subject matter in which the inspector would need expertise would be known to the parties.

#### (b) Inspection procedures

17. The parties may wish to agree on various aspects of the inspection procedure such as: the location and time of inspection; the mandate of an inspector to be designated

jointly; whether, in the case of an inspector designated by the purchaser, the supplier will be informed of the inspector's mandate; the inspector's duty of confidentiality; deadlines for submission of the inspector's report; a requirement that reasons be stated for a finding that the goods are non-conforming; whether sampling and testing procedures customarily used in a particular trade suffice or whether *ad hoc* procedures need to be established; additional inspections or tests when the result of an inspection is contested (e.g., it may be agreed that a party could request a further inspection to be conducted by a second inspector and that the second inspection would be controlling); and cost of inspection.

#### (c) Effect of inspector's finding

18. It may be agreed that the inspector's finding would be regarded as a statement of opinion on the basis of which the parties would consider what steps to take. Alternatively, it may be agreed that a finding by the inspector as to the quality of the goods would directly affect the contractual relationship of the parties. For example, it may be agreed that a supply contract would be deemed concluded in the event that the inspector finds that the goods conform to the quality standard stipulated in the countertrade agreement; in the event of a negative finding, the supplier's offer to conclude a supply contract would be deemed not accepted and the rejection of the goods in question would not constitute a breach of the countertrade commitment. Where the countertrade agreement envisages various levels of quality, it may be agreed that the inspector's finding as to quality would be used in a formula for determining the price of the goods.

## D. Quantity of goods

### 1. General remarks

19. When the countertrade commitment refers to goods of one specified type, the quantity of goods to be purchased may be stipulated in the countertrade agreement or left to be determined at the time of the conclusion of the supply contracts on the basis of the extent of the countertrade commitment. When the parties express the countertrade commitment as a monetary amount, rather than as a quantity of goods to be purchased, they may wish to postpone determining the quantity until the conclusion of the supply contract. Such a postponement would allow fluctuations in the unit price of the goods to be taken into account. An increase in the unit price would mean a reduction in the quantity of goods to be purchased, while a drop in the unit price would mean an increase in the quantity to be purchased. When the countertrade commitment is expressed in terms of the number of units to be purchased, the parties may wish to stipulate a minimum monetary amount so that, in the event of a drop in the unit price, additional units would have to be purchased.

20. When the countertrade agreement provides for several possible types of goods, the quantity of each type of goods that will be purchased may be left to be determined at the time of the conclusion of the supply contracts. The

overall value of the purchases would have to be in conformity with the extent of the commitment set in the countertrade agreement. The countertrade agreement may specify the minimum and maximum percentages of the countertrade commitment that may be fulfilled by purchase of each type of goods.

21. Where the parties are not in a position to determine quantity in the countertrade agreement, it may be useful for the countertrade agreement to set a deadline for agreement on quantity. The parties may refer to a specific date (e.g., 30 days before the close of a subperiod of the fulfilment period) or to an event in the contract in the other direction (e.g., in a buy-back transaction it may be agreed that quantity is to be determined upon the start-up of the plant delivered under the export contract).

22. It may also be agreed that, at specified points in the period for the fulfilment of the countertrade commitment, a party committed to purchase would be obligated to provide an estimate of the quantities of goods expected to be purchased in the upcoming period of time. Similarly, a party committed to supply goods may agree to periodically provide an estimate of the quantity of goods expected to be made available. The parties may wish to agree on a permitted deviation between the estimated quantities and the quantities actually purchased or made available.

23. When the proceeds of the export contract are to be used to pay for the counter-export contract, it is advisable that the parties ensure that the quantity purchased under the export contract is such that the proceeds of the export contract would cover payment for the counter-export contract. Payment mechanisms used in such cases are discussed in chapter IX.

24. If the parties foresee the possibility of purchases of quantities beyond those stipulated in the countertrade agreement, they may wish to consider whether the purchaser's additional orders will be granted any preference over other potential buyers. A related issue is whether the additional quantities would be supplied on the same terms as the original quantities envisaged in the countertrade agreement.

25. The parties may leave the quantity of goods to be determined on the basis of the purchaser's requirements. In such cases, the parties may wish to consider whether the supplier is to be the purchaser's single source for the goods and whether the purchases are to fall within a range specified in the countertrade agreement. The quantity of the goods may also be determined on the basis of the supplier's output of a given product. This approach may be used, for example, in a buy-back transaction. In this case too, the parties may wish to stipulate that the purchases are to fall within a range set in the countertrade agreement.

## 2. *Additionality*

26. When the purchaser has made prior purchases from the supplier of a given type of goods, the provisions in the

countertrade agreement regarding quantity may contain a concept often referred to as "additionality". According to this approach, only those purchases that exceed the usual quantities purchased will be considered as fulfilling the countertrade commitment. The parties would normally be able to establish the threshold of additionality by agreeing on the quantity that is to be regarded as the usual or traditional purchase. When the parties do not identify the type of goods in the countertrade agreement, they may include a general stipulation that if the goods ultimately selected are of a type that the purchaser is already buying, only those purchases above existing levels would be counted toward fulfilment of the countertrade commitment.

27. Where the arrangement allows the purchaser to choose from a number of eligible suppliers other than the party to whom the countertrade commitment is owed (e.g., in an indirect offset transaction), the additionality threshold would not be based on previous trade volume between the parties to the countertrade agreement, but on the trade volume with the suppliers selected or on the volume of previous purchases by the committed party in the suppliers' country. The parties may wish to identify the sources of any trade information to be used in setting the additionality threshold.

## E. *Modification of provisions on type, quality and quantity*

28. A need for a review of provisions on type, quality or quantity of goods may arise due to the unavailability of goods specified in the countertrade agreement, the desire to place additional products on a list, a change in the commercial conditions underlying the transaction, a shift in the commercial objectives of the parties or a governmental regulation affecting the choice of countertrade goods. It could be agreed, particularly in long term transactions, that the parties would review the provisions on type, quality and quantity of goods either at regular intervals or in response to changes in circumstances stipulated in the countertrade agreement (e.g., a change beyond a certain threshold in the price of the goods). The review could be carried out within the framework of a mechanism for monitoring and coordinating fulfilment of the countertrade commitment (see chapter VII, "Fulfilment of countertrade commitment", paragraph \_\_\_\_).

29. In order to avoid a modification procedure, the parties may wish to provide that under certain conditions fulfilment credit would be earned by the purchase of goods other than those agreed upon in the countertrade agreement or appearing on a list of possible countertrade goods. For example, it might be required that the purchases in question meet an additionality test (paragraphs 26 and 27 above), or it may be stipulated that they would earn fulfilment credit at a reduced rate (for further discussion of clauses allowing non-conforming purchases to be counted toward fulfilment of the countertrade commitment, see chapter VII, paragraph \_\_\_\_).

[A/CN.9/332/Add.5]

## CHAPTER VI. PRICING OF GOODS

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**A. General remarks**

1. It is advisable that the parties specify in the countertrade agreement the price of the goods that will be the subject matter of the future supply contract, if they are able to do so. When the parties are not able to set the price in the countertrade agreement, it is advisable to provide a method for determining the price at the time the supply contract is to be concluded. This chapter deals with methods for determining the price after the countertrade agreement has been concluded. In addition, the chapter discusses the currency in which the price is expressed and revision of price.

2. The parties may need to defer setting the price, for example, because the type of goods has not been identified at the time of the conclusion of the countertrade agreement or because there is to be a long interval between the conclusion of the countertrade agreement and the conclusion of a given supply contract. Such an interval may prompt the parties to defer setting the price because of the possibility of price fluctuation or of a change in the underlying economic conditions during the interval. In some cases, the parties may set the price of an initial shipment, but leave the determination of the price of subsequent shipments for a later time. Providing a method for determining the price may help the parties avoid differences over what the appropriate price should be, which may delay or prevent the conclusion of supply contracts.

3. In a barter transaction, it may not be necessary to include a provision on price because the goods shipped in one direction constitute payment for the goods shipped in the other direction. Nevertheless, pricing issues may arise

in a barter transaction if the parties decide to measure the relative value of their shipments in monetary terms, rather than merely in terms of volume and quality, or if the shipments are of different values and the imbalance is to be settled in money. Pricing would also be necessary when customs regulations require that goods entering a country indicate a monetary value.

4. In setting the price of the countertrade goods, it is advisable that the parties specify whether or not the price includes costs ancillary to the costs of the goods themselves, such as transportation or insurance, testing, or customs duties and taxes. Some of the elements of the price may be indicated by using an appropriate trade term such as those defined in the INCOTERMS of the International Chamber of Commerce.

5. The parties may wish to stipulate the point of time when the price is to be calculated, particularly in the case of goods whose price may fluctuate. When the countertrade transaction involves a single shipment or a number of shipments within a relatively short period of time, and the price is to be determined only once, a specified date may be agreed upon. In some cases, the price setting mechanism may be set in motion by an event such as the start-up of a plant under a buy-back transaction or the placing of an order. When multiple shipments are spread out over a longer period of time, several dates for determination of price may be agreed upon or the countertrade agreement may provide a mechanism for revision of the initial price.

6. The parties should bear in mind that there may be mandatory rules that affect the level at which the price

may be set. For example, if the price is set at a low level in relation to the market price, the goods may be subject to anti-dumping import restrictions.

### B. Currency of price

7. The currency in which the price is to be paid may involve certain risks arising from the fluctuation in the purchasing power of that currency and from the fluctuation in exchange rates between that currency and other currencies. If the price is to be paid in the currency of the supplier's country, the purchaser bears the consequences of a change in the exchange rate between that currency and the currency of the purchaser's country. The supplier, however, will bear the consequences of a change in the exchange rate between the currency of the supplier's country and the currency of another country in which the supplier has to pay for equipment, materials or services needed in the production of the goods. If the price is to be paid in the currency of the purchaser's country, the supplier bears the consequences of a change in the exchange rate between this currency and the currency of the supplier's country. If the price is to be paid in the currency of a third country, each party bears the consequences of a change in the exchange rate between this currency and the currency of its respective country. Where a financing institution has granted the purchaser a loan for the purchase of the goods, the purchaser may prefer the price to be paid in the currency in which the loan is granted.

8. In stipulating the currency in which the price is to be paid, the parties should take into consideration foreign exchange regulations and international treaties in force in the countries of the supplier and the purchaser, which may mandatorily govern this question. The parties should also take into account that under some legal systems the price in an international contract must be paid in the currency in which it is denominated, while other legal systems may permit, or even require, payments in the currency of the place of payment, even if the price is denominated in a foreign currency.

9. The countertrade agreement may denominate the price in a currency that the parties consider to be stable or in a unit of account that is not a national currency, but provide that it is to be paid in another currency. The effects of such an approach are similar to those achieved by a currency clause (see paragraphs 37 and 38, below), and restrictions imposed by the applicable law in respect of currency clauses may also apply to such provisions. If this approach is used, it is advisable to agree in the countertrade agreement that the exchange rate is to be the one prevailing at a specified place on a specified date.

10. It is not advisable for the contract to denominate the entire price in two or more currencies, and allow either the debtor or the creditor to decide in which currency the price is to be paid. Under such a clause, only the party having the choice is protected, and the choice may bring the party having the choice unjustified gains.

### C. Determining price after conclusion of countertrade agreement

#### 1. Standards

11. The countertrade agreement may provide for a determination of price through the use of a standard (see chapter III, "Contracting approach", paragraph 50). Such a method provides a price at the time of the conclusion of the supply contract in an objective manner not influenced by the will of the parties.

12. The parties may wish to include a procedure to apply in the event a standard they select proves to be unworkable (e.g., because a market price is not available as expected). For example, the parties may provide that the price is to be determined through the use of an alternate standard or that the price is to be determined by a third person.

#### (a) Market prices for goods of standard quality

13. When goods identified in the countertrade agreement are commodities or semi-finished products (e.g., grains, oil, metals, wool) for which prices are regularly reported, the parties may agree to link the price of the countertrade goods to the reported price. Where the goods are traded on several exchanges or in several markets, the parties are advised to specify a particular exchange or market to which reference will be made. In order to protect against price fluctuations, the standard may call for an average of the prices reported at several agreed points of time (e.g., the prices reported on the first business day of the month for the six months preceding the date of the determination of the price).

#### (b) Production cost

14. The parties may agree that the price is to be based on the supplier's cost of producing the goods, plus an amount to cover the supplier's overhead and profit. Such an approach may be selected when the exact cost of various inputs cannot be anticipated at the time the countertrade agreement is concluded. In order to limit the purchaser's risk of having to pay an excessive price, it is advisable that, where possible, the parties stipulate in the countertrade agreement the quantity of inputs (e.g., raw materials, energy and labour) that will be required for the production of one unit of the goods. The parties may also wish to stipulate that the supplier should maintain records reflecting production costs in accordance with forms and procedures required by the purchaser, and that the purchaser shall have access to those records.

#### (c) Competitor's price

15. The price may be determined on the basis of the price charged by an identified competitor producing the same type of goods as those that will be delivered under the supply contract. If the countertrade agreement does not identify the competitor, it may establish criteria for the selection of a competitor (e.g., geographical criteria or criteria related to the volume of production of the same type of goods). Because the competitor may sell a product at different prices in different geographical regions and

markets, it is advisable that the countertrade agreement identify the market to which reference will be made. The price clause could also indicate how the price information will be obtained and the date as of which the competitor's price is to be determined. Furthermore, the parties may agree to exclude specially discounted prices charged to certain customers (preferential prices). For example, the standard may exclude prices charged for the goods when they are purchased by disaster relief organizations or by employees of the supplier.

16. A competitor's price may not be relevant, without adjustments, if it is based on a significantly larger or smaller quantity than the quantity intended to be purchased under the countertrade agreement. A competitor's price may also not be appropriate if the competitor's goods are of a different quality, if the competitor's price is based on payment conditions (e.g., deferred payment) not being offered by the supplier of the countertrade goods, or if the amount of transportation costs or insurance and public charges contained in the competitor's price differs from what is to be included in the price of the countertrade goods. It is therefore advisable to stipulate that the standard should take into account only prices for shipments that are comparable in quantity, quality, delivery and payment conditions to the future supply contract, or that amounts should be added or subtracted from the competitor's price in order to compensate for differences.

17. The parties may agree that the price is to be determined on the basis of several competitors' prices. Such a clause may identify the competitors or it may provide that each of the parties is to obtain quotations from a specified number of competitors. If the competitors are not identified, it is advisable that a clause of this type specify the countries or regions from which the parties are to obtain the quotations. It is also advisable that the countertrade agreement indicate the manner in which the price is to be calculated (e.g., whether by calculating a mean or a median price). The parties may wish to specify the period of time during which the quotations are to be obtained. In doing so, the parties should take into account the length of time necessary to obtain the quotations as well as the need to base the calculation on current prices.

18. When the party committed to purchase goods manufactures the same type of goods, the parties may agree that the price will be determined on the basis of the price charged by the purchaser or on the basis of the purchaser's own cost of manufacture. Such an approach might be used, for example, in a buy-back transaction in which a producer of a certain type of goods sells a facility that produces that type of goods and agrees to buy back the resultant products.

*(d) Most-favoured-customer clause*

19. It may be agreed that the price of the countertrade goods will be based on the lowest price at which goods of the same type are supplied by the supplier to other customers. In some cases, the parties may restrict the clause to a limited category of customers (e.g., customers in a particular country or customers identified in the countertrade agreement). The parties may wish to indicate the means to

be used to identify the most-favoured customer. For example, the supplier could be required to provide specified types of information indicating the prices charged by the supplier to other customers. It is also advisable to ensure that the most-favoured-customer price is relevant to the shipments to be made pursuant to the countertrade agreement (see paragraph 16 above). The parties may also wish to specify the date as of which the most-favoured-customer price is to be determined. The parties may wish to specify any specially discounted prices (preferential prices) offered by the supplier to certain customers that should not be taken into account (see paragraph 15 above). The scope of the most-favoured-customer clause may be broadened by agreeing that the price will be determined on the basis of the lowest price charged by the supplier or by other specified suppliers of the same type of goods.

*(e) Use of more than one standard*

20. The countertrade agreement may provide that the price is to be determined by a formula involving two or more standards. For example, the price may be determined by averaging the prices derived from the selected standards. Another possibility is for the price derived from a particular standard to be compared with prices derived from one or more other standards. If the difference between the price derived from the selected standard and the prices from the comparator standards does not reach a specified threshold, the price derived from the selected standard would apply. If the difference exceeds a specified threshold, the final price would be, for example, the average of the price derived from the standards. Such techniques may be useful when it is desired to avoid the possibility that the price derived through the use of a single standard might not reflect the market value of a given product at the time the purchase is to be made.

## 2. Negotiation

21. The parties may agree that the price is to be negotiated. For a discussion of procedures the parties may establish for the negotiations, see chapter III, "Contracting approach", paragraphs 39 to 42. It is advisable that, to the degree possible, the parties agree on guidelines for the determination of the price.

22. Such guidelines may establish minimum and maximum limits within which the price is to be negotiated. In establishing such limits, the parties may use price standards of the type described in paragraphs 11 to 20 above. For example, it may be agreed that the price should not be more than 5 per cent higher or more than 5 per cent lower than the price charged by a competitor.

23. Alternatively, guidelines may merely provide a reference price to be taken into account in negotiations. In formulating a guideline of this type, the parties may use price standards such as those described in paragraphs 11 to 20 above. For example, it may be agreed that the price will be negotiated taking into account the price of a particular competitor.

24. A negotiation guideline may also take the form of a statement that the price of goods is to be "competitive",

"reasonable", or at a "world market" level. Such a clause might be acceptable when the goods are of a standard quality. A guideline of this type may be made more precise by specifying, for example, whether the price should be based only on prices paid to the supplier by other buyers or should also be based on prices charged by other suppliers, the period of time the parties should refer to in determining what is a "competitive", "reasonable" or "world market" price, and, if there are variations in prices in different markets, which markets, types of buyers or geographical territories are referred to.

### 3. Determination of price by third person

25. Sometimes the parties provide for the price to be set by an independent third person (e.g., a market specialist in the goods in question). For a discussion of determination of contract terms by third persons, see chapter III, "Contracting approach", paragraphs 53 to 60. Such an approach may also be used as an alternative price setting method in the event that an attempt by the parties themselves to set the price proves unsuccessful.

26. It is advisable for the countertrade agreement to delimit the mandate of the third person by providing guidelines of the type discussed with respect to negotiation (paragraphs 21 to 24 above). The parties may wish to establish deadlines for referral of the matter to a third person, so that the price could be set in time to allow conclusion of contracts as planned.

### 4. Determination of price by one party

27. Sometimes it is agreed that the price will be determined by one of the parties to the countertrade agreement (see chapter III, "Contracting approach", paragraph 61). Legal systems that recognize determination of price by one party tend to require that such determination be subject to guidelines in order to be enforceable. In considering the type of guidelines to use (see paragraphs 21 to 24 above), the parties should bear in mind that legal systems differ as to the degree of precision required. Under some legal systems the determination of the price by one party must be subject to a standard of reasonableness or fairness. When the parties do not refer to a standard of reasonableness or fairness, some of these legal systems will imply a reference to such a standard. Other legal systems require that the latitude of the party determining the price be subject to a standard more definite than reasonableness or fairness.

## D. Revision of price

28. When multiple shipments are spread out over a period of time, there may be a need to revise the price in order to reflect changes in the underlying economic conditions. It may be agreed that a revision would occur at specified points of time. Those points of time should be coordinated with the schedule for the fulfilment of the countertrade commitment (e.g., the revision is to take place four weeks prior to the commencement of a subperiod).

29. Under another approach, it may be agreed that a revision would take place in response to specified changes in underlying economic conditions (e.g., an exchange rate fluctuation beyond a certain percentage from a reference rate in effect on the date the countertrade agreement was concluded or changes beyond an agreed threshold in specified components of production cost such as raw materials or labour). Contractual provisions concerning price revision due to a change in the value of the currency in which the price is to be paid are mandatorily regulated under some legal systems. The parties should, therefore, examine whether a clause which they intend to include in the countertrade agreement is permitted under the law of the country of each party.

30. Yet another approach is to provide for a price revision at regular intervals (e.g., every six months), as well as for unscheduled revisions in response to specified changes in underlying economic conditions. In order to limit the frequency of price revision, it could be agreed that an unscheduled review could not take place within a specified period of time following a review, or within a specified period of time preceding a scheduled review. Yet another approach would be to set the price revision procedure in motion upon the delivery of a specified portion of the total quantity of goods to be purchased.

31. The countertrade agreement might provide for the price revision clause to apply only in cases where its application would result in a revision exceeding a certain percentage of the price.

32. When the countertrade agreement contains a price revision clause, the parties may wish to specify the shipments to which the revised price is to apply. It may be agreed, for example, that the applicable price for a given shipment is the price in effect on the date the goods are ordered or on the date the letter of credit is issued.

### 1. Reapplication of price clause

33. The parties may stipulate in the countertrade agreement that the price is to be revised through the use of the same method as was employed to determine the initial price (standards (paragraphs 11 to 20), negotiation (paragraphs 21 and 24), determination of price by a third person (paragraphs 25 and 26) or determination of price by one party (paragraph 27)).

### 2. Index clause

34. The purpose of index clauses is to revise the price of the countertrade goods by linking the price to the levels of the prices of certain goods or services prevailing on a certain date. A change in the agreed indices automatically effects a change in the price. In formulating an index clause, it is advisable to use an algebraic formula to determine how changes in the specified indices are to be reflected in the price. Several indices, with different weightings given to each index, may be used in combination in the formula in order to reflect the proportion of different cost elements (e.g. materials or services) to the

total cost of construction. Different indices may be contained in a single formula to reflect the costs of different types of materials and services. When the sources of the same cost element (e.g., labour or energy) are in different countries, different indices may be found in a single formula for that cost element.

35. Several factors may be relevant in deciding on the indices to be used. The indices should be readily available (e.g. they should be published at regular intervals). They should be reliable. Indices published by recognized bodies (such as well-established chambers of commerce), or governmental or inter-governmental agencies, may be selected. The parties should exercise caution in using indices based on different currencies in a formula, as changes in the relationships between the currencies may affect the operation of the formula in unintended ways.

36. In some countries, particularly in developing countries, the range of indices available for use in an index clause may be limited. If an index is not available for a particular element of costs, the parties may wish to use an available index in respect of another element. It is advisable to choose an element whose price is likely to fluctuate in approximately the same proportions and at the same times as the actual element to be used. For example, in cases where it is desired to provide an index for labour costs, a consumer price index or cost-of-living index is sometimes used if there is no wage index available.

### 3. *Change in exchange rate of currency in which price is payable*

#### (a) *Currency clause*

37. Under a currency clause, the price to be paid is linked to an exchange rate between the currency in which the price is to be paid and a certain other currency (referred to as the "reference currency") determined at the time of entering into the countertrade agreement. If this rate of exchange has changed at the time of payment, the price to be paid is increased or decreased in such a way that the amount of the price in terms of the reference currency remains unchanged. For purposes of determining the applicable exchange rate, it may be desirable to adopt the time of actual payment, rather than the time when the payment falls due. If the latter time is adopted, the sup-

plier may suffer a loss if the purchaser delays payment. Alternatively, the supplier may be given a choice between the exchange rate prevailing at the time when payment falls due or that prevailing at the time of actual payment. It is advisable to specify an exchange rate prevailing at a particular place.

38. The reference currency should be stable. The insecurity arising from the potential instability of a single reference currency may be reduced by reference to several currencies. The contract may determine an arithmetic average of the exchange rates between the currency in which the price is payable and several other specified currencies, and provide for revision of the price in accordance with changes in this average.

#### (b) *Unit-of-account clause*

39. If a unit-of-account clause is used, the price is denominated in a monetary unit of account composed of cumulative proportions of a number of selected currencies. In contrast to a clause in which several currencies are used (paragraph 38 above), the weighting given to each selected currency of which such a monetary unit of account is composed is usually not the same, and greater weight is given to currencies generally used in international trade. The unit of account may be one that is established by an intergovernmental institution or by agreement between two or more States and that specifies the selected currencies making up the unit and the relative weighting given to each currency (e.g., Special Drawing Right (SDR), European Currency Unit (ECU), or Unit of Account of the Preferential Trade Area for Eastern and Southern African States (UAPTA)). In choosing a unit of account, the parties should consider whether the relation between the currency in which the price is payable and the unit of account can be easily determined at the relevant times, i.e., at the time of entering into the supply contract and at the time of actual payment.

40. The value of a unit of account composed of a basket of currencies is relatively stable, since the weakness of one currency of which the unit of account is composed is usually balanced by the strength of another currency. The use of such a unit of account will therefore give substantial protection against changes in exchange rates of the currency in which the price is payable in relation to other currencies.

[A/CN.9/332/Add.6]

## CHAPTER IX. PAYMENT

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### A. General remarks

1. The parties may decide that the payment obligation under the supply contract in one direction is to be liquidated independently from the payment obligation under the supply contract in the other direction. When payments are independent, the payment under each supply contract is made in a way that is used in trade generally, such as payment on open account, payment against documents, or letters of credit. Alternatively, the parties may decide to link payment so that the proceeds generated by the contract in one direction would be used to pay for the contract in the other direction, thus allowing the transfer of funds between the parties to be avoided or reduced. The legal guide discusses only linked payment arrangements. It does not discuss independent payment arrangements since they do not raise issues specific to countertrade.

2. One reason the parties may have for linking payments is the expectation that it would be difficult for a party to effect payment in the agreed currency. Another reason may be to ensure that the proceeds generated by the shipment in one direction would be used to pay for the ship-

ment in the other direction. Payment mechanisms designed to meet such needs include retention of funds by the importer (paragraphs 6 to 10 below), blocking funds paid under the export contract through blocked accounts or crossed letters of credit to secure their availability to pay for the counter-export contract (paragraphs 11 to 34 below), and setoff of countervailing claims for payment (paragraphs 35 to 52 below).

3. An aspect of linked payment mechanisms to be considered is the financing costs that result from the fact that linked payment mechanisms immobilize the proceeds of shipments made by the parties. The longer the interval between the time the proceeds are generated by the contract in one direction and the time those proceeds are used to pay for the contract in the other direction, the greater the financing costs are likely to be.

4. The parties may wish to consider the possibility of interference by a third party in the functioning of the linked payment mechanism. For example, a creditor of one of the countertrade parties may seize proceeds of a supply contract or a payment claim of the debtor, the bank

holding the funds may become insolvent or governmental authorities may intervene to prevent payment due to shortage of foreign exchange. Such interference could result in the freezing of the payment mechanism until the claim against the countertrade party is adjudicated or a governmental measure lifted. A factor in assessing this risk is the degree of protection the law applicable to the payment mechanism affords against third-party interference. Furthermore, the longer funds are held in the payment mechanism, or claims for payment wait to be set off, the greater the risk of third-party interference.

5. It should be noted that payment mechanisms may require governmental authorization if they involve a delay in or an absence of repatriation of the proceeds of a supply contract, the holding of funds abroad or the holding of a domestic account in a foreign currency.

### B. Retention of funds by importer

6. Sometimes it is agreed that the shipment in a particular direction (export contract) is to precede the shipment in the other direction (counter-export contract), and that the proceeds of the export contract are to be used to pay for the subsequent counter-export. Such cases are sometimes referred to as "advance purchase" in view of the fact that the importer is to purchase goods in advance in order to generate financing for the counter-export contract. In such cases, the parties may agree that the proceeds of the export contract will be held under the control of the importer until payment under the counter-export contract becomes due.

7. A consideration as to the acceptability of such an arrangement would be the exporter's confidence that the importer will hold the funds in accordance with the countertrade agreement. Such confidence is more likely to exist when the parties have an established relationship. Another consideration is the risk that the importer will become insolvent or that the funds in the hands of the importer will be subject to a third-party claim. Under ordinary circumstances the claim of the exporter would have no priority over that of another creditor of the importer. In some legal systems, the funds may enjoy a degree of protection against the claims of third parties if the agreement concerning the retention of funds places the importer in a fiduciary position with respect to the funds. For example, in common law systems, this might be done by establishing a "trust" in which the importer acts as the "trustee" of the funds. Fiduciary mechanisms available in some other legal systems may offer similar protection.

8. Furthermore, if the countertrade agreement does not specify the type of goods to be counter-exported, or if no standard exists to measure the quality of the type of goods agreed upon, a disagreement may arise over the type, quality or price of counter-export goods. The possibility of such a disagreement increases the risk that for an unacceptable period of time the retained funds will neither be put to the intended use nor released to the exporter. When the parties are able to specify the type of goods, a consideration affecting the acceptability of retention of funds by the importer may be the length of time required to make the counter-export goods available. Retention of funds by

the importer might be more acceptable when the goods to be purchased with the retained funds are available in stock and can be shipped quickly, and less acceptable when the goods have to be specially manufactured.

9. An appropriate balance needs to be established between two opposing objectives. One objective is to assure the exporter access to the funds if the counter-export did not take place. The other objective is to assure the importer that the funds will not be transferred to the exporter, at least not the full amount, if the exporter is in breach of the commitment under the countertrade agreement to counter-import. The first objective may be advanced by fixing a date by which the funds have to be transferred to the exporter in the event the counter-export has not taken place. The second objective may be advanced by authorizing the importer to deduct any liquidated damages or penalty that may be due to the importer for the exporter's breach of the countertrade commitment before the funds are returned to the exporter.

10. Depending upon the length of time the funds are to be retained under the control of the importer, the parties may wish to consider providing in the countertrade agreement for the payment of interest. If they do so, the parties may stipulate the manner in which the funds are to be deposited so as to earn the most favourable rate of interest.

### C. Blocking of funds

#### 1. General remarks

11. When the exporter does not wish to leave the funds generated by the export contract under the control of the importer, the parties may wish to use another payment mechanism designed to ensure that the proceeds of the first shipment are used for the intended purpose. The legal guide addresses two mechanisms of this type, blocked accounts and crossed letters of credit.

12. When the parties opt for a blocked account, they agree that the importer's payment is to be deposited in an account at a financial institution agreed upon by the parties and that the use and release of the money will be subject to certain conditions. After the funds have been deposited in the account, the importer counter-exports and obtains payment from those funds by presentation of agreed upon documentation evidencing the performance of the counter-export contract to the institution administering the account. Accounts of this nature have been referred to as "escrow", "trust", "special", "fiduciary" or "blocked" accounts. The expression "blocked account" is used here in order to avoid unintended references to particular varieties of such accounts that may be encountered in different legal systems.

13. When the parties opt for crossed letters of credit, the importer opens a letter of credit to cover payment for the export contract ("export letter of credit"). The export letter of credit then serves as the basis for the issuance of a letter of credit to pay for the counter-export contract ("counter-export letter of credit"). Pursuant to the instructions of the parties, the proceeds of the export letter of credit are

blocked in order to cover the counter-export letter of credit. The export letter of credit is liquidated when the exporter presents the required documents, including an irrevocable instruction that the proceeds should be used to cover payment under the counter-export letter of credit. Payment under the counter-export letter of credit, which is funded by the export letter of credit, is effected upon presentation of the required documents by the counter-exporter.

14. A blocked account or crossed letters of credit may be used when the importer does not wish to ship the counter-export goods until the availability of funds to pay for those goods is secured. In such "advance purchase" arrangements, both blocked accounts and crossed letters of credit provide security that the funds generated by the shipment in one direction, specifically designated to occur first, would be used to pay for the subsequent shipment in the other direction.

15. The financial drawbacks of blocking funds may be mitigated to some degree if interest accrues on the blocked funds. A bank holding funds designated for paying letters of credit may be less inclined to pay interest than a bank holding funds in a blocked account. For this reason, a blocked account may provide an interest-bearing vehicle for holding excess funds in anticipation of future orders. This may be helpful in cases where the parties are not certain at the outset as to whether all the proceeds generated by the export will be needed to pay for the counter-export.

## 2. *Blocked accounts*

16. Some legal systems provide special legal regimes for blocked accounts if they are established in a particular legal form (e.g., "trust" account or "*compte fiduciaire*"). In those legal systems, a blocked account would be subject to general contract law if it is not established in such a particular form. When a special legal regime is applicable, the holder of the funds is subject to special fiduciary obligations with respect to the disposition of the funds and the funds may enjoy a degree of protection against seizure by third-party creditors.

17. Contractual provisions outlining the agreement of the parties on the blocked account will be found in the countertrade agreement. In addition, an agreement will have to be concluded between the bank and one or more of the countertrade parties ("blocked account agreement", paragraphs 23 to 27 below). The provisions in the supply contracts concerning the blocked account will normally be limited to identifying the account to be used for payment.

### (a) *Countertrade agreement*

#### (i) *Location of account*

18. The parties should consider stipulating in the countertrade agreement the location of the account. They may do so by identifying the bank, indicating the country in which the account is to be opened or providing some other criterion for selection of the bank. The choice of possible locations of the account may be limited if the legal system of the party whose shipment generated the

funds restricts the right to hold currency abroad. In such a case the choice may be limited to establishing the account with a bank located in that party's country.

19. When the parties have a choice as to the location of the bank, they should bear in mind that the location of the account may determine the law applicable to the account. The suitability of the applicable law in a given location may be assessed in view of the security provided to the parties that the fiduciary obligations of the bank will be properly exercised. Furthermore, it is desirable that the applicable legal regime provide some protection against interference by a third-party creditor of one of the parties. As noted in paragraph 16 above, a degree of protection may be available under some legal systems against claims of third persons.

#### (ii) *Operation of blocked account*

20. It is advisable that the countertrade agreement contain certain basic provisions to be incorporated in the blocked account agreement with the bank. Such provisions enable each party, upon agreeing to the use of a blocked account, to establish that the account will have the features it considers important. These provisions concern, in particular, procedures for the transfer of funds into the account, documentary requirements for transfer of funds out of the account (e.g., payment request using a prescribed form, bill of lading or other shipping document, certificate of quality) and interest. In addressing the contents of the blocked account agreement in the countertrade agreement, the parties should be aware that the bank is likely to be accustomed to handling blocked accounts on the basis of contract forms or standard conditions.

21. The countertrade agreement may provide that payments into the account would be made through a letter of credit opened by the importer in favour of the exporter. It may also be agreed that disbursement of the funds held in the account would be carried out through a letter of credit opened by the counter-importer in favour of the counter-exporter. In such cases it is advisable that the countertrade agreement specify the instructions to be given to the issuing banks and the documents to be presented under the letters of credit. For example, the beneficiary would be required to present, along with documents evidencing shipment, an irrevocable instruction that the proceeds should be deposited in the blocked account.

#### (iii) *Other issues*

22. It is advisable that the countertrade agreement address issues such as amount of funds to be blocked, interest, transfer of unused or excess funds, and any supplementary payments (for a discussion of various issues common to linked payment mechanisms that might be dealt with in the countertrade agreement, see paragraphs 53 to 60 below).

### (b) *Blocked account agreement*

23. The blocked account agreement would contain instructions to the bank and specify the actions to be taken by the trading parties and the bank, as well as other provisions concerning the operation of the blocked ac-

count. The blocked account agreement would also address issues such as interest and bank charges. It is important to ensure that the blocked account agreement is consistent with the provisions in the countertrade agreement concerning the blocked account.

(i) *Parties*

24. The blocked account agreement will be concluded between the bank holding the account and one or more of the countertrade parties. In some cases, an additional bank may be a signatory to the blocked account agreement. That may occur where the funds to be paid into the account are to be channelled, by agreement or by mandatory law, through a particular bank. Some legal systems require that a blocked account established abroad be held in the name of its central bank and that that bank be a party to the blocked account agreement. In multi-party countertrade situations where the counter-exporter or counter-importer are distinct from the exporter and importer, the additional trading parties may also be parties to the blocked account agreement.

(ii) *Transfer of funds into and out of account*

25. The blocked account agreement would set out procedures customarily used by the bank in administering a blocked account. It is advisable that the parties make sure that their agreement as to the manner in which the funds are to be paid into the account and disbursed from the account to the counter-exporter (see paragraphs 20 and 21 above) is reflected in the blocked account agreement. It may be useful to indicate whether partial drawings are permitted, the manner in which the amount to be paid is to be determined (e.g., on the basis of the face value of the invoice) and whether notification of payment requests would be made to the party that deposited funds in the account. The blocked account agreement would also describe the conditions under which excess or unused funds should be transferred to the exporter, or applied according to his instructions (see paragraphs 57 and 58 below). In the latter case, the blocked account agreement may indicate the terms on which funds would be held before instructions are received from the exporter.

26. It should be noted that the bank holding the blocked funds may require that its responsibility be limited to examining the conformity of the documents included in the counter-exporter's request for payment with the agreed upon requirements, rather than ascertaining whether the underlying contract has been performed. The bank may also require that the counter-exporter, who will be paid from the account, indemnify the bank against costs, claims, expenses (other than normal administrative and operating expenses) and liabilities which the bank may incur in connection with the blocked account.

(iii) *Duration and closing of account*

27. In order to ensure the availability of the blocked account for the necessary period of time, the blocked agreement should specify that the account will remain open until a certain date or for a period of time following the entry into force of the countertrade agreement. The parties may wish to provide that the blocked account

would remain operative for a period of time (e.g., 60 days) following the end of the period for the fulfilment of the countertrade commitment. Such a time period would enable the transaction to be completed as planned in the event that shipment under the counter-export contract took place just before expiry of the fulfilment period or was delayed for justified reasons. The blocked account agreement could indicate circumstances in which the account would close, in addition to the passage of an agreed upon period of time. These could include an event such as rescission of the export contract or of the countertrade agreement.

### 3. *Crossed letters of credit*

28. Where the parties wish to block funds using crossed letters of credit, it is advisable that the countertrade agreement include provisions concerning the designation of the participating banks (see paragraph 54 below), the instructions to be given to the participating banks for the issuance of the export letter of credit and the counter-export letter of credit and for the allocation of their proceeds, and the documents to be presented in order to obtain payment. In addition, the parties would have to stipulate that the shipment and presentation of documents in one direction should precede the shipment and presentation of documents in the other direction.

(a) *Sequence of issuance*

29. The parties may agree that the counter-export letter of credit should be issued prior to the issuance of the export letter of credit. Such a sequence of issuance may be an important consideration to a counter-exporter whose motive to conclude the import contract was the expectation of being able to counter-export. The failure to issue the counter-export letter of credit, and the resultant absence of a counter-export, may leave the importer liable for costs associated with the import that the importer had originally intended to cover by the proceeds of the counter-export (e.g., commission to a third person for resale of goods purchased under the export contract). In order to protect the interest of the exporter who agrees to open the counter-export letter of credit before the export letter of credit is issued, the parties may agree that payment under the counter-export letter of credit will require documentary proof of the issuance of the export letter of credit.

30. In some cases the parties may decide to open the counter-export letter of credit only when the proceeds of the export letter of credit would be available to cover the counter-export letter of credit. In order to address the risk that the export letter of credit is opened without the counter-export letter of credit being subsequently issued, the parties may wish to include an appropriate liquidated damages or penalty provision in the countertrade agreement.

(b) *Instructions for allocation of proceeds*

31. The instructions from the importer for the issuance of the export letter of credit should provide that the documents required to be presented to obtain payment include irrevocable instructions from the exporter that the

proceeds of the export letter of credit should be used to pay for the counter-export letter of credit upon presentation of the shipping documents relating to the counter-export. The instructions for issuance of the counter-export letter of credit should indicate that payment is to be made using the proceeds of the export letter of credit.

32. The choice as to the form of payment is limited to payment at sight or payment on a deferred basis. The other option used in practice to delay payment of a letter of credit, payment by acceptance of a draft, is incompatible with the linked payment objective of the crossed letters of credit. If the draft were transferred to a third person, the issuer of the export letter of credit would normally be obligated to pay the holder (and the importer would be obligated to reimburse the issuing bank) independently of the crossed letter of credit payment scheme and the performance of the counter-export. If the export letter of credit is payable at sight, the issuing bank is given an irrevocable instruction to retain the funds until a given date for the purpose of paying the counter-export letter of credit. If the export letter of credit is a deferred-payment letter of credit, the bank issuing the export letter of credit would be instructed that, upon the date payment is due, the funds are to be used for payment under the counter-export letter of credit.

33. It is advisable that the instructions for the issuance of the export letter of credit stipulate that the proceeds of the export letter of credit would be paid to the exporter in the event the counter-export fails to materialize. Under an export letter of credit payable at sight, the proceeds would be paid to the exporter if by an agreed date the counter-export goods have not been shipped. If the export letter of credit is payable on a deferred basis, it could be provided that the proceeds will be paid to the exporter if, by the payment date, the counter-exporter has not presented the required documents. Payment to the exporter would also be in order when the proceeds of the export letter of credit exceed what is needed to cover the counter-export letter of credit. If such a situation is foreseen, it is advisable that the importer instruct the issuer of the export letter of credit to transfer to the exporter any proceeds of that letter of credit that are in excess of the specified amount needed to cover the counter-export letter of credit.

#### (c) *Expiry dates*

34. It is advisable that the counter-export letter of credit expire a reasonable period of time after the expiry of the export letter of credit. Where the two letters of credit have an identical or almost identical expiry date, insufficient time may remain for shipment and presentation of documents under the counter-export contract if shipment and presentation of documents under the export contract took place at the last minute.

### D. *Setoff of countervailing claims for payment*

#### 1. *General remarks*

35. The parties may agree that their mutual claims for payment based on shipments made in each direction

would be set off. Under such an arrangement, each party is compensated for its deliveries through deliveries of goods from the other party. Money is not actually paid except to settle an imbalance in the values of the shipments in the two directions.

36. A setoff approach may be utilized when only one shipment is to be made in each direction or when multiple shipments are to be made in the two directions over a longer period of time. The present section discusses the record-keeping mechanism that the parties may wish to use to set off payment claims of multiple shipments. Such a record-keeping mechanism, referred to in the legal guide as a "setoff account", is referred to in practice by various terms, including "compensation account", "settlement account" or "trade account".

37. A setoff account may be administered by the parties themselves or by a bank. The engagement of a bank may be prescribed by mandatory rules of law. Banks are also used because the parties may wish that the debit and credit entries in the setoff account be made on the basis of shipping documents examined in accordance with procedures customarily used by banks. Furthermore, banks engaged to administer a setoff account may agree to guarantee the obligation of a countertrade party to liquidate an imbalance in the flow of trade.

38. Under one approach to structuring a setoff account, two accounts are maintained for recording debit and credit entries, one at a bank in the country of one party and another one at a bank in the country of the other party. Another approach would be to use a single account administered by a single bank; other banks may be involved for the purpose of forwarding documents and issuing or advising letters of credit.

39. When two banks are involved in administering the setoff arrangement, it is probable that they will conclude an interbank agreement. This interbank agreement may cover some of the points already addressed in the countertrade agreement, as well as establish the technical arrangements relating to the setoff account. The countertrade agreement may refer to the interbank agreement, stating that the technical details of the operation of the accounts will be in accordance with an interbank agreement concluded between the participating banks. Although the countertrade parties are not normally signatories to an interbank agreement, it is advisable that the countertrade parties participate in the preparation of the interbank agreement in order to ensure consistency between the countertrade agreement and the interbank agreement (interbank agreements are discussed in paragraphs 55 and 56 below).

40. The legal guide does not address State-to-State umbrella agreements for mutual trade within the framework of a clearing account between governmental banking authorities. Under such arrangements the value of deliveries in the two directions is recorded in a currency or unit of account and eventually set off between the governmental banking authorities. Individual traders in each country conclude contracts directly with each other but submit their claims for payment to their respective central or

foreign trade bank and receive payment in local currency. Similarly, purchasers pay their respective central or foreign trade bank in local currency for their imports. Such clearing mechanisms, which might be part of economic measures designed to promote trade, fall outside the ambit of the legal guide since the individual supply contracts in one direction concluded under the umbrella agreement are not contractually linked to contracts concluded in the other direction.

## 2. Countertrade agreement

### (a) Effecting credit and debit entries

41. The parties may wish to agree that entries in the account will be made on the basis of documents. The countertrade agreement should stipulate the documents required to be presented by the supplier in order to obtain a credit. The type of documents stipulated depends on the point of time in the execution of a supply contract at which the parties wish to allow credit to be given to the supplier. These documents might include, for example, invoices, packing lists, certificates of quality or quantity, bills of lading or other transport documents, evidence of the customs clearance of the goods in the receiving country or of their acceptance by the purchaser, and any other documents stipulated under the individual supply contracts. The parties may also wish to agree on the contents of any statement which the supplier would be required to make concerning the transaction being credited (e.g., purchase order number, date of shipment, description of the type, quantity and value of the goods, number and weight of the packages, particulars concerning carriage, and reference to the setoff account.)

42. Where it is agreed that entries in the account are to be made on the basis of events occurring in the country of destination (e.g., customs clearance or acceptance by the purchaser), the parties may wish to maintain a parallel record of shipments already in transit, but not yet cleared by customs or accepted by the purchaser. Such a parallel mechanism would provide an indication of the upcoming claims for payment that would be entered in the account once goods in transit have cleared customs or have been accepted by the purchaser. This information would enable the parties to apply certain provisions of the setoff mechanism (e.g., limits on outstanding balance, paragraph 49 below, and settlement of imbalance, paragraphs 50 and 51 below) with greater flexibility than might otherwise be the case. For example, the parties may agree that the application of a balance limit to a party in a debit position could be suspended if the value of goods in transit were to be taken into consideration. This would permit a party who would otherwise be barred from receiving additional shipments of goods to continue receiving goods.

43. In a setoff arrangement comprised of a single account, the parties may agree that the presentation of the agreed documents to the administering bank triggers the appropriate debiting or crediting action. A setoff arrangement comprised of two accounts could operate as follows: the purchaser, through its bank, submits to the supplier's bank a copy of a purchase order, and any other documents

stipulated in the countertrade agreement or specified in the purchase order. On receipt of the required documents, the supplier's bank debits the purchaser's account. Upon passing the debit entry, the supplier's bank forwards the documents to the purchaser's bank, along with a statement concerning the effective date of the debit entry. The effective date of the debit entry, as agreed upon in the inter-bank agreement, may be, for example, the date when the documents are dispatched by the supplier's bank to the purchaser's bank. Upon receipt of the documents, the purchaser's bank makes in its books a corresponding credit entry in the supplier's account.

44. Because a setoff account is used for recording the values of shipments rather than for making payments, the use of letters of credit is not necessary. When letters of credit are used, they are used in order to apply established procedures for examination of shipping documents rather than for transferring money. In such cases, the countertrade agreement, in addition to stipulating the instructions to be given to the issuing banks, may provide that letters of credit be subject to the Uniform Customs and Practice for Documentary Credits (1983 Revision, Publication 400 of the International Chamber of Commerce).

### (b) Calculation of entries

45. The countertrade agreement should indicate the currency or unit of account in which the values of the deliveries are to be expressed (paragraph 53 below). In addition, the parties may wish to address the question whether interest calculated on the amount of an imbalance would be registered in the setoff account. Furthermore, the parties may wish to stipulate whether debit and credit entries can be made only on the basis of the required documents evidencing shipment or also on the basis of any claims arising from defective goods or delayed shipment. If debit and credit entries are made only on the basis of shipping documents, claims relating to defective performance of supply contracts would be settled apart from the setoff mechanism. If, however, the parties agree that claims based on defective performance of supply contracts would affect the balance of the setoff account, it is advisable to stipulate the types of documents that would have to be presented in order to alter the balance of the setoff account. For example, the countertrade agreement could require an arbitral award, or a statement by the defaulting party, indicating the amount involved.

46. In order to protect the setoff mechanism against uncertainty that may result from taxation, the parties and the banks may agree that taxes will be paid separately. Such a provision is intended to facilitate the trade balancing aim of the clearing mechanism by allowing the full value of a given shipment to be credited.

### (c) Statements of account

47. An issue relevant to setoff accounts is the manner in which the participating bank or banks will be expected to furnish reports on the status of the setoff account to each other or to the trading parties. The agreement of the parties on this issue in the countertrade agreement is particularly relevant where one bank maintains the account on behalf of both parties. Where two banks are

involved, the question of reporting may be covered in the interbank agreement. Issues to be agreed upon include the frequency, timing and contents of the reports, procedure for objections and period of time within which objections must be made before a report is deemed accepted.

(d) *Periodic verification*

48. In order to minimize the possibility of errors or discrepancies in the setoff account, the parties may agree to verify the recorded value of shipments in the two directions at fixed points of time. The determination of the outstanding balance can be based, for example, on the preceding statement of account that has been accepted and the subsequent debit and credit entries advised in the agreed upon manner. The parties may wish to be specific as to the length of time within which the checking procedure must be completed (e.g., within seven days of the fixed points of time).

(e) *Limits on outstanding balance*

49. The parties may agree that at any point in time during the course of the setoff arrangement a credit or debit balance in the setoff account with respect to either party would not exceed an agreed upon balance limit. In accordance with such a balance limit (sometimes referred to as a "swing"), debit and credit entries would not be entered in excess of the balance limit. It could also be provided that shipments of goods would be suspended to a party whose acceptance of goods without shipping a sufficient quantity in return had resulted in a debit balance reaching the agreed upon limit. Shipments to that party, and the corresponding debit entries, would resume once the debit balance had been brought within the permissible range.

(f) *Settlement of imbalance*

50. It is advisable that the parties agree in the countertrade agreement on the manner in which imbalances in the flow of trade that remain at the conclusion of the fulfilment period, or at the conclusion of subperiods of the fulfilment period, are to be settled. With respect to imbalances remaining at the conclusion of subperiods, it may be agreed that an imbalance up to a certain limit would be added to the obligation of a party in the next subperiod. Any remaining amount that exceeded the limit and was not permitted to be carried forward to the next subperiod would have to be settled by cash or deliveries of goods within a specified shorter period of time. The purpose of limiting the amount of imbalance that can be carried forward is to reduce the risk of an imbalance developing that would be difficult to rectify by the conclusion of the fulfilment period.

51. It may be agreed that an imbalance remaining at the conclusion of the fulfilment period is to be liquidated by a currency transfer within an agreed period of time. Alternatively, the parties may agree upon settlement by supplementary exports to be carried out within a fixed period of time, with any imbalance still remaining after the conclusion of the supplementary period to be settled by a currency transfer within an agreed period of time.

(g) *Guarantee for payment of outstanding balance*

52. In a setoff arrangement involving two banks, each bank may guarantee the obligation to liquidate any outstanding imbalance. Where a single account is maintained by one bank on behalf of both parties, a guarantee covering liquidation of an imbalance can be maintained by that bank in favour of whichever of the parties has the outstanding credit balance. The parties may agree that the costs of maintaining such a guarantee be apportioned between them. The amount of a guarantee for payment of outstanding balance is normally limited to the permitted balance limits under the setoff arrangement. (For further discussion of such guarantees, see chapter XII, "Security for performance", paragraphs 38 to 45.) Parties should be aware that there may be cases, however, where remittance of sums claimed under such guarantees would be subject to prior scrutiny and authorization of exchange control authorities. Sometimes it is possible to obtain prior authorization from exchange control authorities for the remittance of the payment under the guarantee.

**E. Issues common to linked payment mechanisms**

**1. Currency or unit of account**

53. The parties should designate the currency or unit of account in which the payment mechanism will operate. A factor of particular importance is stability in exchange rates of the chosen currency. Because of this consideration, the parties may wish to consider using a unit of account (e.g., SDR (Special Drawing Right), ECU (European Currency Unit) or UAPTA (Unit of Account of the Preferential Trade Area for Eastern and Southern African States)). Another factor in choosing a currency is that it be one in which the goods to be traded are typically valued. In setoff accounts, the currency in which the account operates takes on the character of a unit of account because payments are not made in setoff accounts except to liquidate imbalances in trade. The parties may therefore denominate a setoff account in a currency that they would not use if payments actually had to be made for each shipment.

**2. Designation of banks**

54. The parties may wish to designate in the countertrade agreement the bank or banks they intend to use to administer the payment mechanism and issue any related letters of credit. When the parties do not designate a bank in the countertrade agreement, they may wish to agree, for example, that the bank would have to have its place of business in a particular country, that the bank must be acceptable to both parties or that the bank selected must be agreeable to an interest-bearing payment mechanism.

**3. Interbank agreement**

55. Where a bank is involved on each side of the countertrade transaction, the participating banks may conclude an interbank agreement concerning technical and procedural aspects of the payment mechanism. The inter-

bank agreement would cover issues such as: statements of account; procedures for notification of interest due; how often interest is to be recorded; interbank communications for the purpose of advising debit and credit entries and transmission of documents; procedures for verification of entries in accounts; banking charges; and modification and assignment of the interbank agreement. Though the countertrade parties are not normally parties to the interbank agreement, they have an interest in the contents of the interbank agreement in view of its role in structuring the payment arrangement. It is therefore advisable that the countertrade parties consult with their banks to ensure that the terms of the interbank agreement are consistent with the terms of the countertrade agreement concerning payment.

56. The entry into force and duration of the interbank agreement may be linked to the entry into force and duration of the countertrade agreement in order to ensure the availability of the payment mechanism at the time the countertrade transaction is to be carried out. It is desirable to provide for the interbank arrangement to continue beyond the expiry or termination of the countertrade agreement for the purpose of settling any outstanding balance. In order to provide the trading parties an opportunity to approve the interbank agreement, the countertrade parties and participating banks might agree that the interbank agreement will enter into force upon the approval by the countertrade parties. In some countries the interbank agreement may require approval of exchange control or other governmental authorities.

#### 4. *Transfer of unused or excess funds*

57. It is advisable that the parties provide for payment to the exporter of the proceeds of the export contract, or application of the proceeds according to the exporter's instructions, in the event that the counter-export does not take place by the agreed date. In order to address the concern of the importer about an arbitrary non-fulfilment of the countertrade commitment, it may be agreed that an amount equivalent to the sum that may be due from the exporter as damages, liquidated damages or penalty for breach of the countertrade commitment would be retained or transferred to a third party pending the resolution of a dispute as to responsibility for the non-fulfilment of the countertrade commitment.

58. A similar provision may be included with respect to funds generated by the export that are in excess of the amount needed to cover the price of the counter-export contract. Transfer of unused funds is also an issue when the parties agree that only a portion of the proceeds of the export contract is to be retained (e.g., as a deposit towards payment for the counter-export), and that the balance due under the counter-export will be paid at the time it becomes due.

#### 5. *Supplementary payments or deliveries*

59. The parties may anticipate that their shipments will not be of the same value or in the planned quantity so that

the proceeds of the shipment in one direction will be insufficient to cover payment for the shipment in the other direction. In such cases, it is advisable to agree whether the difference would be settled through additional deliveries or through cash payments.

#### 6. *Bank commissions and charges*

60. It would be advisable for the parties to address in the countertrade agreement the question of payment of banking charges for operation of the payment mechanism, including the cost of any related letters of credit. In order to simplify the operation of the payment arrangement, it may be agreed that banking commissions and charges will be recorded separately from entries pertaining to shipment of goods. Where a single bank is used which acts on behalf of both parties, it may be agreed that the banking charges will be shared equally. Where a bank is involved on both sides of the transaction, it may be agreed that the charges of each bank will be paid by its respective client. According to an alternative method of apportioning costs for letters of credit, charges for the issuance of a letter of credit are borne by the purchaser, while charges for negotiation and confirmation, if required, are borne by the supplier. Extensions or other amendments of letters of credit could be borne by the party responsible for such extension or amendment.

#### F. *Payment aspects of multi-party countertrade transactions*

##### 1. *General remarks*

61. A countertrade transaction may involve one or more third parties. In some cases, in addition to the exporter and the importer, a third-party counter-importer is involved ("three-party countertrade"); in other cases, in addition to the exporter and the importer, a third-party counter-exporter is involved ("three-party countertrade"); in yet other cases, in addition to the exporter and the importer, both a third-party counter-importer and a third-party counter-exporter are involved ("four-party countertrade") (see chapter VIII, "Participation of third persons", paragraphs — to —). The engagement of a third-party counter-importer may occur when the importer needs to sell goods in order to secure funds to cover the cost of the import, but the exporter is not interested in purchasing or is not able to purchase what the importer has to sell. A third-party counter-exporter may be engaged when the importer itself does not have goods of interest to the exporter.

62. If the parties agree that the payment obligations under the export contract and under the counter-export contract are to be settled independently, a countertrade transaction involving third parties does not raise payment issues specific to countertrade. Issues specific to countertrade are raised if the proceeds of the contract between one pair of parties (e.g., importer and exporter) will be used to pay for a contract between a different pair of parties (e.g., importer and third-party counter-importer). In such cases, as described in the following two para-



graphs, a party receiving goods does not pay or ship to the party supplying those goods, but instead pays or ships to a third party.

63. In a three-party countertrade transaction involving a third-party counter-importer, the importer, instead of transferring money to the exporter under the export contract, delivers goods to the counter-importer and is considered to have discharged the payment obligation for the import up to the value of countertrade goods delivered to the counter-importer. The counter-importer, in turn, pays the exporter an amount equivalent to the value of the goods received from the counter-exporter. Similarly, in a three-party transaction involving a third-party counter-exporter, the importer transfers funds to the counter-exporter to pay for the shipment to the counter-importer and the counter-importer (exporter) agrees that the claim for payment under the export contract is discharged by the value of the goods that have been counter-exported to him.

64. In a four-party countertrade transaction, where the counter-exporter is a separate party from the importer and the counter-importer is a separate party from the exporter, the exporter ships goods to the importer and the importer, instead of paying the exporter, pays to the counter-exporter an amount equivalent to the value of the goods received from the exporter. The payment from the importer to the counter-exporter compensates the counter-exporter for the shipment to the counter-importer. The counter-importer pays to the exporter an amount equivalent to the value of the goods received from the counter-exporter.

65. Payment in a multi-party countertrade transaction may be structured so that cross-border payment would not be necessary. This would be possible, as between an importer and an exporter, when the importer and the third-party counter-exporter are located in the same country or when the exporter and a third-party counter-importer are located in the same country. When both the counter-exporter and the counter-importer are third parties, cross-border payments may be avoided if both the exporter and the counter-importer are both located in one country and if the importer and the counter-exporter are both located in another country. Where cross border transfer of currency does not take place, payments would be made in local currency between parties on each side of the transaction.

66. In multi-party countertrade, in addition to the payment-related provisions in the countertrade agreement and the export and counter-export contracts, there would also be agreements between the exporter and the counter-importer or between the importer and the counter-exporter concerning payment in local currency equivalent to the value of the goods received by a given party and the payment of a commission. Furthermore, an agreement may be concluded between the participating banks concerning the payment mechanism.

67. The countertrade agreement should describe the performance for which each party is responsible, the

sequence in which shipments are to take place, the manner and sequence of payments, and the instructions to be given to the participating banks. A multi-party countertrade transaction with a linked payment mechanism requires coordination of the actions of the participating parties and of the instructions given to the participating banks. It is advisable to have a single countertrade agreement, signed by all the participating parties. Where not all the parties to a multi-party transaction are parties to the countertrade agreement, it may be necessary to include in the individual supply contracts terms concerning the linked payment mechanisms.

## 2. *Blocking of funds in multi-party countertrade*

68. As in countertrade involving two parties, blocked accounts and crossed letters of credit may be used in multi-party countertrade. Issues relevant to the use of blocked accounts and crossed letters of credit are discussed in paragraphs 11 to 34 above.

69. When a blocked account is used in a four-party transaction, or in a three-party transaction involving a third-party counter-exporter, the proceeds of the export contract would be held in a blocked account until presentation of documents evidencing performance of the counter-export contract, at which point the funds would be transferred to the counter-exporter. In the event that, by the deadline for presentation of documents evidencing performance of the counter-export contract, those documents have not been presented, the funds would be transferred to the exporter. In order to establish payment through a blocked account, the exporter and importer conclude a blocked account agreement with the bank selected to administer the account.

70. When crossed letters of credit are used in a three-party transaction involving a third-party counter-exporter, the counter-importer (exporter) opens a letter of credit in favour of the counter-exporter (counter-export letter of credit). Cover for the counter-export letter of credit is obtained from the proceeds of the letter of credit opened by the importer for the benefit of the exporter (export letter of credit). The exporter obtains access to the shipping documents relating to the counter-export goods by presenting evidence of shipment under the export contract and an instruction that the proceeds of the export letter of credit should be used to cover the counter-export letter of credit. Similarly, in the case of a three-party transaction involving a third-party counter-importer, the proceeds of the export letter of credit could be used to cover the counter-export letter of credit.

71. When crossed letters of credit are used in a four-party transaction, the importer, who obtains the issuance of the export letter of credit, deposits with the issuing bank of the export letter of credit the amount of that letter of credit. Upon the instruction of the exporter, the proceeds of the export letter of credit are not paid to the exporter, but are blocked to cover the counter-export letter of credit. Upon the presentation by the counter-exporter of shipping documents under the counter-export letter of credit, the funds deposited by the importer to cover issu-

ance of the export letter of credit are paid to the counter-exporter; on the other side of the transaction, the counter-importer pays the exporter an amount equivalent to the value of the goods received by the counter-importer. If the

counter-exporter does not present shipping documents under the counter-export letter of credit, the funds deposited by the importer to cover the export letter of credit would be transferred to the exporter.

[A/CN.9/332/Add.7]

## XII. SECURITY FOR PERFORMANCE

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#### A. General remarks

1. The legal guide focuses on guarantees (also referred to in practice as "bonds" or "indemnities") in a countertrade transaction supporting the countertrade commitment. Such a guarantee may support the obligation of the party committed to purchase countertrade goods, as well as the obligation of the party committed to supply goods. Sometimes a guarantee supports the countertrade commitment by way of securing payment under a liquidated damages or penalty clause covering the countertrade commitment. Guarantees particular to countertrade may also be used to support liquidation of imbalances in the flow of trade (paragraphs 38 to 45 below). Guarantees supporting the performance of individual supply contracts are not specifically addressed since they do not raise issues particular to countertrade.

2. Requiring guarantees may have the general advantage of preventing parties who are unreliable or who do not have sufficient financial resources from participating in the countertrade transaction. Guarantor institutions generally make careful inquiries about a party whose obligations they are asked to guarantee, and will normally provide guarantees only when they have reasonable ground for believing that the party can successfully perform the obligation. This may be of particular advantage to importers or exporters who are otherwise unable to determine whether the proposed counter-party is reliable.

3. Depending upon its terms, a guarantee may be independent of, or accessory to, the underlying obligation. Under an independent guarantee, the guarantor's obligation to pay does not depend on whether the obligated party (the "principal"), who procures the guarantee, has in fact breached the underlying obligation, but on whether the party to whom the obligation is owed (the "beneficiary") has complied with the payment conditions of the guarantee (for a discussion of payment conditions, see paragraphs 15 to 20 below). Upon meeting the payment conditions, the beneficiary receives prompt payment even if there is disagreement between the principal and the beneficiary as to whether the underlying obligation has been breached. It would be up to the principal, in an action for recovery of the amount paid, to prove that the obligation had not been breached. Despite the fact that a guarantor's obligation to pay may be independent from the underlying obligation, the right of the beneficiary to claim under the guarantee may under the law applicable to the guarantee be excluded in exceptional circumstances, in particular when the claim by the beneficiary is fraudulent.

4. Under an accessory guarantee, the guarantor must pay only when the principal is in fact in breach of the guaranteed obligation. Such accessory guarantees are referred to in national laws by terms such as "suretyship", "cautionnement", "garantía", and "Bürgschaft". The guarantor must, before paying a claim, ascertain whether the underlying obligation was breached in order to establish

whether the claim is justified, and the guarantor is normally entitled to invoke all the defences that the principal could invoke against the beneficiary.

5. The discussion in the legal guide is limited to independent guarantees, without thereby implying a preference for this type of guarantee. Generally, independent guarantees are used to support obligations set out in the countertrade agreement. While principals tend to prefer accessory guarantees, beneficiaries are normally reluctant to accept such guarantees because of the possible delays involved in obtaining payment. Moreover, guarantors, in particular banks, tend to prefer independent guarantees because they do not wish to investigate the performance of the underlying obligation. While the various legal regimes governing accessory guarantees are well established, independent guarantees, essentially a creation of banking and commercial practice, are not yet firmly established in all legal systems and there is no uniformity as regards the extent to which independent guarantees are recognized.

6. In some countries banks issue "stand-by letters of credit", which are the functional equivalent of independent guarantees. Accordingly, the discussion in the legal guide on guarantees for security for performance by the principal applies to stand-by letters of credit.

## **B. Guarantee provisions in countertrade agreement**

7. When the parties decide to use a guarantee to support the countertrade commitment, they should include in the countertrade agreement certain basic provisions concerning the issuance and terms of the guarantee. The parties may also wish to consider appending to the countertrade agreement a form of a guarantee to be followed by the issuer in establishing the guarantee. In formulating the terms of the future guarantee in the countertrade agreement, the parties should be sure that the agreed formulation would be accepted by the guarantor.

8. Typically it is the party committed to purchase whose commitment is supported by a guarantee. In many cases this is because the primary objective of that party in agreeing to a countertrade commitment is to secure a sale, rather than to obtain goods from the other party. When the party committed to purchase goods has a particular interest in obtaining the goods, the supplier's commitment to conclude a contract for the supply of the agreed goods may be supported by a guarantee. In some cases, the countertrade agreement may require both the purchaser and the supplier to obtain guarantees to support their commitments. When the parties to the countertrade agreement foresee that a third person may assume the countertrade commitment, the parties may wish to consider whether the guarantee should be procured by the party originally committed to purchase or supply the goods or by the third person (see chapter VIII, "Participation of third persons").

9. When the guarantee supports the principal's obligation under a liquidated damages or penalty clause, the question whether a payment under the guarantee would free the principal from liability for fulfilment of the

countertrade commitment would be settled by the terms of the liquidated damages or penalty clause and the rules applicable to the clause (see chapter XI, "Liquidated damages and penalties", paragraphs \_\_\_\_ to \_\_\_\_). When the guarantee does not support a liquidated damages or penalty clause and the parties intend, as is sometimes the case, that payment under the guarantee would have the effect of freeing the principal from the countertrade commitment or from liability for any damages exceeding the amount paid under the guarantee, they should state their intention in the countertrade agreement. Without a provision to this effect, it cannot be assumed that payment under the guarantee would free the principal from the countertrade commitment or from liability for damages.

### *1. Choice of guarantor*

10. The parties may wish to specify in the countertrade agreement a guarantor who would be acceptable to both parties. That would enable the beneficiary to be satisfied that the guarantee would be issued by a guarantor that had the necessary financial reserves and that was otherwise acceptable. The identification of the guarantor could be useful to both parties in that it would limit subsequent disagreements and enable the parties to know the cost of the guarantee at the outset.

11. If the guarantor is not identified at the time of the conclusion of the countertrade agreement, the parties may provide, for example, that the guarantor be a first class bank, be agreeable to the beneficiary or be an institution from the home country of one of the parties.

12. A beneficiary may wish to have the guarantee issued by an institution in its home country because enforcement of a claim for payment against such an institution could be easier than against a foreign institution. However, requiring the use of a local guarantor may be disadvantageous to the extent that the principal is prevented from using a guarantor with whom it has an established relationship and who may provide the same guarantee at a lower cost.

13. In some legal systems, mandatory rules applicable to the beneficiary provide that a guarantee may be accepted only if it is issued by a financial institution in the country or a financial institution authorized to issue guarantees involving payment in a foreign currency or if the selection of the guarantor is approved by the competent authority.

14. There have been instances where an undertaking to pay a sum of money, termed a "guarantee", supporting the countertrade commitment or the payment of related liquidated damages or penalties has been made by the party whose countertrade commitment is to be guaranteed. The effect of such a "guarantee" is that the party-guarantor promises to pay the other party under the terms of the guarantee without raising any defence that could not have been raised by a third-party guarantor, and that it is up to the party-guarantor to sue for reimbursement of the funds paid if it is claimed that the underlying obligation had not been breached. Such a guarantee might be acceptable to the beneficiary if the guarantee is independent from the underlying transaction and is issued by a trading party

whose commercial integrity and financial adequacy are regarded by the beneficiary as being beyond doubt. However, it is not clear that such a guarantee gives the beneficiary legal rights in addition to those arising from the obligation being guaranteed.

## 2. *Conditions for obtaining payment under the guarantee*

15. The countertrade agreement should clearly set forth the conditions that have to be fulfilled in order for the guarantor to be obligated to pay, in particular, as to any documents that have to be submitted in support of a claim for payment. Disputes may arise from uncertainty as to whether the documents presented by the beneficiary conform to the terms of the guarantee.

16. The terms of an independent guarantee may provide that a demand for payment alone would suffice or that the demand would have to be accompanied by the beneficiary's statement concerning the breach. A general declaration to that effect may be sufficient. Alternatively, the beneficiary may be required to state more details, such as the nature of the principal's breach, that the beneficiary is entitled to payment of the claimed amount and that the amount has not yet been paid. In addition to the demand for payment, the beneficiary may be required to present documents issued by a third person relating to the default by the principal, such as an arbitral award or court decision stating that the default has occurred. The guarantee may provide that the requirement of a third-person statement would be obviated if the principal makes an admission of default in writing. In all these cases, the guarantor merely ascertains whether the documents conform on their face to the requirements of the guarantee and is not to inquire into the underlying transaction. In particular, the guarantor is not to investigate whether the statements contained in a document are founded.

17. Sometimes the parties agree that the beneficiary must notify the principal of the intention to call the guarantee and that the claim cannot be made before the expiry of a specified period of time following the notice. The purpose of such a notice requirement is to provide an opportunity to the principal to cure a breach or to settle a disagreement. A corollary guarantee term would require the beneficiary to submit with the demand for payment documentary evidence that notice had been given to the principal.

18. Where the guarantee supports the payment obligation under a liquidated damages or penalty clause, the parties may wish to stipulate that among the payment conditions would be a requirement that the beneficiary provide a statement that payment under the liquidated damages or penalty clause is due.

19. In addition to documentary conditions, a guarantee will usually specify requirements that do not pertain to the performance of the underlying obligation. Such requirements, which do not involve the presentation of a document, most frequently concern the time period within which a claim can be made, the amount of the guarantee,

and the office of the guarantor where the claim is to be submitted.

20. It is advisable that the countertrade agreement, in addition to setting out the agreement of the parties as to the guarantee, provide that the beneficiary is entitled to claim under the guarantee only if there is in fact a failure to fulfil the commitment. Such a provision might facilitate recovery by the principal of losses suffered in the event a claim has been paid without there having been a breach of the underlying obligation.

## 3. *Amount of guarantee and reduction of amount*

21. The parties should agree on the amount of the guarantee, as well as the currency in which it is to be denominated and payable. The amount of the guarantee is expressed as a specified amount or as a percentage of the value of the outstanding commitment. If the guarantee is supporting payment under a liquidated damages or penalty clause, the guarantee clause in the countertrade agreement may call for payment of the entire amount of the liquidated damages or penalty or a portion thereof. The liquidated damages or penalty may itself be a certain percentage of the unfulfilled countertrade commitment.

22. In determining the amount of the guarantee, or of the liquidated damages or penalty covered by the guarantee, the parties would take into account factors such as the extent of the losses expected to be suffered in the event of non-fulfilment and the risk of failure to fulfil, as well as the limits which guarantors would usually observe in respect of similar contracts. Another factor may be the ease with which payment of a claim under the guarantee can be obtained. In this respect, the beneficiary generally has a trade-off to make. The closer the terms of the guarantee approach that of a simple demand guarantee and the easier it will be to obtain payment, the less willing the principal will be for the guarantee to cover a high percentage of the countertrade commitment. On the other hand, if the documentary conditions are more difficult to meet when the principal has not breached the commitment (e.g., when an arbitral or court decision must be presented), the principal may be willing to agree on a higher amount for the guarantee.

23. The parties may wish to include in the terms of the guarantee a mechanism to reduce the amount of the guarantee as fulfilment of the countertrade commitment progresses. Reduction of the guarantee amount would have the advantage of reducing the exposure under the guarantee and possibly the cost of the guarantee. If the guarantee secures payment of liquidated damages or a penalty, the provisions on the reduction of the guarantee should be consistent with any reduction mechanism for the sum of the liquidated damages or penalty.

24. It is advisable that the reduction mechanism operate on the basis of the presentation to the guarantor of specified documents evidencing fulfilment of the countertrade commitment, without the guarantor being obligated to verify the degree to which the countertrade commitment has been fulfilled. These documents may include shipping

documents, copies of supply contracts, purchase orders, letters of release or other documents recording fulfilment. The parties may also find it useful to stipulate the issuer of the documents and the party responsible for forwarding them to the guarantor. Where the fulfilment period is divided into subperiods, the parties may wish to provide that the guarantee will be reduced by the amount allocated for each subperiod and not claimed within the agreed period of time.

#### 4. Time of providing guarantee

##### (a) At entry into force of countertrade agreement or shortly thereafter

25. The parties are advised to agree on the point of time when the guarantee is to be issued. It may be agreed, for example, that the guarantee should be issued to the beneficiary when the countertrade agreement enters into force or shortly thereafter (e.g., thirty days after entry into force of the countertrade agreement). The parties may obtain assurance that the guarantee would be procured at the agreed time by providing that the countertrade agreement would not enter into force without procurement of the guarantee or that the principal would be deemed to have breached the countertrade commitment if the guarantee was not procured within the agreed period of time.

26. When a contract in one direction (export contract) is concluded together with the countertrade agreement, the parties could agree that the issuance of a guarantee supporting fulfilment of the countertrade commitment is a condition for the entry into force of the export contract. Such a provision would assure the importer of not being bound under the export contract before issuance of a guarantee to support the countertrade commitment.

##### (b) Later in fulfilment period

27. The parties may agree that the guarantee does not have to be procured until a certain date later in the fulfilment period provided that at that time fulfilment of the commitment has not been completed. The agreed date may be, for example, three months before the end of the fulfilment period or three months before the end of each yearly segment of a multi-year fulfilment schedule. This approach has the advantage that the amount of the guarantee could be calculated as a percentage of the then outstanding countertrade commitment. By making the amount of the guarantee dependent on the outstanding balance rather than on the entire countertrade commitment and by limiting the length of time during which a guarantee is in effect, the extent of exposure under the guarantee as well as the cost of the guarantee are likely to be reduced.

28. Since such an approach exposes the beneficiary to the risk that the guarantee will not be procured, the parties may wish to agree on the beneficiary's rights in the event the guarantee is not procured as agreed. It may be agreed that the beneficiary would be permitted to regard the countertrade commitment as breached and to claim payment under a liquidated damages or penalty clause. Furthermore, it might be agreed that the beneficiary would be

entitled to deduct the amount of the liquidated damages or penalty from any amounts becoming due under the export contract after the failure to procure the guarantee.

#### 5. Duration of guarantee

##### (a) Expiry date

29. It is advisable for the parties to agree in the countertrade agreement on the length of time the guarantee is to remain in force. One possible approach would be to provide for an open-ended guarantee that would terminate only when fulfilment of the commitment is deemed to be achieved or the committed party is otherwise released from the commitment (see chapter VII, "Fulfilment of countertrade commitment", paragraphs — to —). Another approach would be to provide a fixed expiry date. It should be noted that most guarantors may be willing to issue guarantees only if the expiry date is fixed. Furthermore, the Uniform Customs and Practice for Documentary Credits (1983 Revision, Publication No. 400 of the International Chamber of Commerce), under which stand-by letters of credit may be issued, calls, in its article 46, for the stipulation of an expiry date for presentation of documents.

30. It is advisable that the expiry date of the guarantee fall after the end of the period for the fulfilment of the countertrade commitment. A period of time between expiry of the fulfilment period and expiry of the guarantee (e.g., thirty days) would allow the beneficiary to await the conclusion of supply contracts until the close of the fulfilment period without foregoing the possibility of claiming payment under the guarantee. Furthermore, the beneficiary, at its discretion, would be able to allow minor delays attributable to the principal in the fulfilment of the countertrade commitment without foregoing the possibility of claiming payment under the guarantee. At the same time, a relatively short interval would allow the liability of the guarantor to be resolved relatively soon after the alleged non-fulfilment of the countertrade commitment has taken place. The parties may also wish to apply such an approach in relation to guarantees covering subperiods of a fulfilment period.

31. If the security takes the form of a stand-by letter of credit, it should state expressly that it is irrevocable. The need for such a statement arises because article 7(c) of the Uniform Customs and Practice for Documentary Credits (1983 Revision, Publication No. 400 of the International Chamber of Commerce), which will often be applicable, provides that a credit is deemed to be revocable in the absence of an express indication that it is irrevocable.

##### (b) Return of guarantee instrument

32. In some legal systems a guarantee may remain in force even after the expiry date if the guarantee instrument is not returned by the beneficiary. The countertrade agreement should therefore obligate the beneficiary to return the guarantee promptly upon fulfilment of the guaranteed obligation. However, the obligation to return the guarantee should be drafted so as not to imply that if the guarantee is not returned it remains in force even after the expiry date.

*(c) Extension*

33. For various reasons, the time period for fulfilment of the countertrade commitment may be extended and as a result continue beyond the expiry date of the guarantee (see chapter VII, "Fulfilment of countertrade commitment", paragraphs \_\_\_\_ to \_\_\_\_, concerning extension of the fulfilment period). The countertrade agreement might provide that, if the fulfilment period is extended, the principal would be obligated to arrange within a reasonable period of time a corresponding extension of the guarantee. Alternatively, the guarantee might provide for an automatic extension to cover any extension of the underlying fulfilment period agreed to by the parties. However, such a provision might not be acceptable to a guarantor who does not wish to be bound by a guarantee whose duration depends on an agreement to which the guarantor is not a party.

34. With respect to the cost of extending the period of validity of the guarantee, the parties may wish to agree that the party responsible for the extension of the fulfilment period will be obligated to bear the costs of the extension of the guarantee period.

#### 6. *Modification or termination of countertrade agreement*

35. In legal systems that recognize the agreement of the parties to establish an independent guarantee, an independent guarantee would remain in effect as stipulated regardless of changes in the underlying commitment. If the change in the underlying contract affects the possibility to obtain the documents in support of the payment claim under the independent guarantee, it should be ensured that the change in the underlying contract be reflected by a corresponding modification of the guarantee terms.

36. Under some legal systems that do not fully recognize an independent guarantee, an alteration of the underlying commitment may result in the release of the guarantor; under other such systems, the guarantee may be deemed to cover only the commitment of the principal existing at the date of issuance of the guarantee. With a view to avoiding undesired consequences, the parties may provide that the guarantee would remain in force despite modifications of the countertrade agreement.

37. The modification of the countertrade agreement may extend the liability of the principal beyond the amount of the guarantee. The parties may wish to provide in the countertrade agreement that in those cases the principal would be obligated to ensure that the amount of the guarantee would be modified accordingly.

#### C. *Guarantee for imbalance in trade*

38. The parties may agree that goods will be shipped in exchange for goods and that the shipments in each direction will not be paid for in money. This type of transaction may be based on a barter contract (see chapter III, "Contracting approach", paragraphs \_\_\_\_ to \_\_\_\_ ) or on the

setoff of countervailing claims for payment (see chapter IX, "Payment", paragraphs \_\_\_\_ to \_\_\_\_ ). In such cases a supplier runs the risk that the value of its shipments may exceed the value of goods received from the other party and that this surplus is not liquidated, either by supplies of goods or through payment in money. In order to address this risk, the parties may use guarantees to secure liquidation of an imbalance that may develop in the flow of trade.

39. The amount of the guarantee should be linked to the amount of the imbalance in the flow of trade, with an upper limit. This upper limit for the guarantee could be set at the level of imbalance permitted under the countertrade transaction. It may be agreed that the amount that could be claimed under the guarantee would cover less than the full extent of the imbalance (e.g., 80 percent). The purpose of such an approach would be to discourage the calling of the guarantee except as a last resort. A beneficiary who cannot recover the full amount of the imbalance by calling the guarantee would have a greater incentive to achieve the agreed balance in the flow of trade through ordering goods from the other party.

#### 1. *Guarantee for shipment in one direction*

40. Where a particular sequence of shipments in the two directions is stipulated, the countertrade agreement may provide that the party scheduled to receive goods first must provide a guarantee supporting the obligation to ship goods in return. This guarantee would cover the risk taken by the party that ships first that the return shipment fails to take place by the agreed date or is not of the agreed value or quantity. When the first shipment is to take place in stages, it may be agreed that with each partial shipment a separate guarantee is to be provided corresponding to the value of that shipment; alternatively, the guarantor may agree to increase the amount of the guarantee upon the presentation of documents evidencing additional shipments.

41. With respect to the timing of the issuance of the guarantee, the countertrade agreement may provide that the guarantee is to be handed over to the beneficiary in exchange for the shipping documents relating to the first delivery. Such a procedure would safeguard against the possibility that the party scheduled to ship first obtains the guarantee but fails to ship. In order to ensure that the beneficiary of the guarantee (the party that has shipped first) would not be in a position to claim payment under the guarantee once the principal (the party shipping second) has fulfilled its obligation to ship goods, the countertrade parties may agree that the beneficiary of the guarantee would obtain documents of title to the second shipment only upon surrender of the guarantee instrument.

42. Guarantees may be used in a similar fashion in multi-party countertrade transactions. When the parties link deliveries in such a fashion that the importer, in exchange for goods received from the exporter, ships goods to a third-party counter-importer, the third-party counter-importer pays the exporter (see chapter IX, "Payment", paragraphs \_\_\_\_ to \_\_\_\_ ). The guarantee, pro-

vided by the importer, would support the obligation to counter-export after receiving the export goods. When the exporter is to be paid by the counter-importer upon shipment of the export goods, the counter-importer would be the beneficiary of the guarantee. Such a guarantee would cover the risk taken by the counter-importer in paying the exporter prior to receiving goods from the counter-exporter. When, however, the counter-importer is to pay the exporter only upon receipt of the counter-export goods, the exporter would be the beneficiary of the guarantee. Such a guarantee would cover the risk that the exporter, having shipped goods, failed to be paid by the counter-importer because the counter-export did not take place.

43. A similar guarantee may be used when the exporter, instead of being paid by the importer, receives goods from a third-party counter-exporter, who in turn is paid by the importer (see chapter IX, "Payment", paragraphs \_\_\_\_ to \_\_\_\_). In this case, it may be agreed that the exporter would be given a guarantee covering the risk that, having shipped first, the exporter failed to be compensated by a shipment of goods from the counter-exporter.

44. A guarantee may be employed in a similar fashion when both the counter-importer and the counter-exporter are separate parties from the exporter and the importer (see chapter IX, "Payment", paragraphs \_\_\_\_ to \_\_\_\_). It

may be agreed that the importer must provide a guarantee to the exporter to support the importer's obligation to pay the price of the export goods. When the exporter is to receive payment from the counter-importer upon shipment of the export goods, the beneficiary would be the counter-importer. This would protect the counter-importer against the risk of paying the exporter without receiving goods from the counter-exporter. When, however, the counter-importer is to pay the exporter only upon shipment of the counter-export goods, the beneficiary of the guarantee would be the exporter. This would protect the exporter against the risk of shipping goods without being paid.

## 2. *Mutual guarantees*

45. When the parties agree to exchange goods for goods, they may do so without stipulating a particular sequence in which the shipments in the two directions should take place. This is particularly likely when multiple shipments in each direction are envisaged. In such situations, both parties encounter the risk of an imbalance in the flow of trade which needs to be redressed either through the shipment of goods or through the payment of a sum of money. To address this risk, it may be agreed that each party is to provide a guarantee to secure liquidation of an imbalance in favour of the other party.

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

### A. Report of the Working Group on International Contract Practices on the work of its thirteenth session

(New York, 8-18 January 1990) (A/CN.9/330) [Original: English]

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## INTRODUCTION

1. Pursuant to a decision taken by the Commission at its twenty-first session,<sup>1</sup> the Working Group on International Contract Practices devoted its twelfth session to a review of the draft Uniform Rules on Guarantees being prepared by the International Chamber of Commerce and to an examination of the desirability and feasibility of any future work relating to greater uniformity at the statutory law level in respect of guarantees and stand-by letters of credit. The Working Group recommended that work be initiated on the preparation of a uniform law, whether in the form of a model law or in the form of a convention.
2. The Commission, at its twenty-second session, accepted the recommendation of the Working Group that work on a uniform law should be undertaken and entrusted this task to the Working Group. The Secretariat was requested to prepare the necessary documentation.<sup>2</sup>
3. The Working Group, which was composed of all States members of the Commission, held its thirteenth session in New York from 8 to 18 January 1990. The session was attended by representatives of the following States members of the Working Group: Argentina, Bulgaria, Cameroon, Canada, Chile, China, Cuba, Czechoslovakia, Egypt, France, Germany, Federal Republic of, Hungary, India, Iran (Islamic Republic of), Japan, Kenya, Lesotho, Libyan Arab Jamahiriya, Mexico, Morocco, Spain, Union of Soviet Socialist Republics, United Kingdom of Great Britain and Northern Ireland, United States of America and Yugoslavia.
4. The session was attended by observers from the following States: Australia, Austria, Colombia, Ecuador, Finland, German Democratic Republic, Indonesia, Liberia, Malawi, Myanmar, Poland, Republic of Korea, Sweden, Switzerland, Thailand, Tunisia, Uganda and United Republic of Tanzania.
5. The session was attended by observers from the following international organizations: International Monetary Fund, International Chamber of Commerce, European Banking Federation.
6. The Working Group elected the following officers:  
*Chairman:* Mr. R. Illescas Ortiz (Spain)  
*Rapporteur:* Ms. R. M. Pinelo (Cuba)
7. The Working Group had before it the following documents: provisional agenda (A/CN.9/WG.II/WP.64), and a note by the Secretariat containing the discussion of some issues of a uniform law: substantive scope of uniform law, party autonomy and its limits, and rules of interpretation (A/CN.9/WG.II/WP.65).
8. The Working Group adopted the following agenda:
  1. Election of officers.
  2. Adoption of the agenda.

3. Possible issues of a uniform law on guarantees and stand-by letters of credit.
4. Other business.
5. Adoption of the report.

## I. DELIBERATIONS AND DECISIONS

9. The Working Group commenced its work entrusted to it by the Commission by considering the possible issues of a uniform law as discussed in the note by the Secretariat (A/CN.9/WG.II/WP.65). The deliberations and conclusions of the Working Group are set forth below in sections A to C of chapter II.
10. The Working Group engaged in a preliminary exchange of views on further possible issues to be covered by the uniform law, as set forth below in section D of chapter II.

## II. POSSIBLE ISSUES OF A UNIFORM LAW ON GUARANTEES AND STAND-BY LETTERS OF CREDIT

## A. Substantive scope of the uniform law

1. *General discussion on the purpose and substantive scope of the uniform law*

11. General remarks were made on the purpose of the future uniform law and on its substantive scope. As regards the purpose of the uniform law, it was suggested that the uniform law should serve a bridging function by overcoming essential disparities between different legal systems. Its scope should be modest and focus on essential issues such as validity and enforceability, time of effectiveness and expiry, liability of the parties and objections to payment. A view was expressed that the uniform law should not unduly restrict party autonomy and that the form of a model law was preferable to that of a convention. On the latter point, the Working Group was agreed that it was premature to take a decision at this early stage.
12. It was further stated that the uniform law should not adversely affect established and sound guarantee and letter-of-credit practice and its future development. In this connection, it was suggested that the uniform law should aim at coherence with pertinent uniform rules elaborated by the International Chamber of Commerce. With a view to avoiding inconsistency or conflicts, the uniform law should focus on those issues that could not effectively be dealt with by contractual rules.<sup>3</sup>
13. As regards the types of instrument to be covered by the uniform law, the prevailing view was that the uniform law should focus on independent guarantees and stand-by letters of credit and that it could be extended to traditional commercial letters of credit where that would be useful in view of their independent nature and the need to regulate equally relevant issues.

<sup>1</sup>Official Records of the General Assembly, Forty-third Session, Supplement No. 17 (A/43/17), para. 18.

<sup>2</sup>Ibid., Forty-fourth Session, Supplement No. 17 (A/44/17), para. 244.

<sup>3</sup>See also discussion below, paras. 62-63, 66-67.

14. The view was expressed that the stand-by letter of credit should be dealt with clearly separately from the independent guarantee because of its different functional origin. The prevailing view, however, was in favour of a joint treatment in view of their common operational legal character and functional equivalence. The uniform law could adopt a common name for these two instruments such as the term "guaranty letter" suggested by the Secretariat. A view was expressed that a possible generic name embracing also the commercial letter of credit, i.e., all three types of independent instruments to be covered by the uniform law where that was possible and appropriate, could be, for example, "independent financial assurance".

## 2. Possible elements of a definition of "guaranty letter"

15. The Working Group discussed the possible elements of a definition of "guaranty letter" on the basis of the considerations and suggestions set forth in the above note (A/CN.9/WG.II/WP.65, paras. 21-47). It was understood that the discussion of such elements, while primarily concerning the definition of "guaranty letter", was often relevant also for later consideration in the drafting of operative provisions.

### (a) Independent undertaking to pay

16. The Working Group was agreed that the definition of guaranty letter should contain the idea of an independent undertaking to pay. The term "undertaking", or possibly "promise", was preferred to expressions like "contract", "agreement" or "arrangement" in that it did not take a stand on the controversial question of the legal characterization as unilateral or bilateral. A view was expressed that the expression "to pay" might be too narrow and that a more appropriate expression might be "to honour" or "to credit". As regards the object of payment, it was stated that it should be understood to be of a financial nature.

17. As regards the qualification of the undertaking as "independent", the Working Group was agreed that this was an important element that should be included in the definition, in particular for the purpose of drawing a demarcation line to accessory guarantees, which were to be excluded from the uniform law. It was noted that the concept of independence of the guarantor's undertaking concerned primarily the so-called underlying transaction between the principal and the beneficiary but also other relationships such as that between the guarantor and the principal and that between the guarantor and a counter-guarantor.

18. As regards possible ways of expressing the concept of independence, it was suggested that the guarantor could be precluded from invoking against the beneficiary the defences that the principal could invoke against the beneficiary or that the principal could invoke against the guarantor, especially as arising out of a claimed inconsistency between the instructions of the principal and the guaranty letter as issued. This expression of independence was felt by some to be more appropriate than a more categorical one such as "the guarantee is independent of

any underlying transaction or other relationship". It was feared that the latter expression might be construed as an absolute prohibition of referring to any instance relating to the underlying transaction and thus, for example, preclude possible recourse to such instance in case of fraud or abuse of right.

19. In a similar vein, it was felt that an expression of independence should not be too categorical and absolute so as to hinder the appropriate treatment of more specific issues such as the admissibility of pre-establishment conditions, non-documentary payment conditions or other agreed guarantee terms. It was concluded, therefore, that the definition should contain a statement of principle and that the concept of independence had to be refined and elaborated in various contexts of operative provisions.

### (b) Compliance with terms and conditions

20. The Working Group was agreed that compliance with the terms and conditions set forth in the guaranty letter should be included as an element in the definition of guaranty letter, even though it may be regarded as a self-evident requirement. Its inclusion would help to characterize the undertaking and to clarify that the undertaking was shaped only by those terms set forth in the guaranty letter and not by any extraneous conditions. It was understood that any such reference to compliance did not take a stand on such questions as whether certain terms or conditions might be inadmissible or whether certain terms or conditions were required for the guaranty letter to be valid.

### (c) Definite or determinable amount and currency of payment

21. It was observed that a reference to the payment of money or currency may be too narrow in that it would exclude, for example, an undertaking to pay in gold. It was, therefore, suggested that a wider wording such as "payment of anything that is stated in the guaranty letter" should be used. It was understood that any such reference in the definition merely expressed a principle and did not address specific questions such as the admissibility of a given object of payment or the possible need for providing a mechanism of conversion.

22. The Working Group was agreed that the amount payable should not be required to be definite but that it had to be at least determinable. It was noted that guaranty letters without a definite amount were being used in practice and, for example, provided for reductions according to the decrease in the guaranteed risk (e.g., progress of works covered by a performance guarantee). Concerns were expressed that the necessary determination in such cases might undermine the independent nature of the undertaking, unless the amount was specified to be available by definite instalments. In order to meet those concerns, it was suggested that the determination should be one that could be readily made by the guarantor, for example, on the basis of clearly specified documents.

### (d) Claim within specified period of time

23. The Working Group was agreed that a demand for payment had to be made within any specified period of

validity or effectiveness. For that purpose, it was necessary to provide certainty as to the exact point of time when the period commenced to run, that is, the date of establishment or effectiveness. It was equally important to determine the exact point of expiry, be it an expiry date or an expiry event, which should be determined on the basis of a document or, possibly, other ready means. Both issues had to be addressed in the operative rules of the uniform law.

24. It was noted that in practice guaranty letters were found that did not specify a period of validity or effectiveness. In view of that practice, the uniform law should not require guaranty letters to contain such a specification. However, various concerns were expressed with respect to such undertakings of indeterminate validity. Perpetual undertakings were regarded as unsettling and commercially undesirable owing to their lack of finality. They also raised regulatory concerns in view of their continuing liability and risk exposure. Moreover, they created uncertainty in that they might be affected by a statute of limitations of an applicable law which in itself might be difficult to determine. As to the latter point, it was felt that there was a need for further study of the possible impact of statutes of limitation on undertakings without a specified validity period.

25. In order to meet those concerns, it was suggested that the uniform law should provide a cut-off period of, say, 5 or 10 years for those guaranty letters that did not specify a period of validity. A concern was expressed that such a provision, if it prevented the issuance of guaranty letters that specified perpetual validity, might not be acceptable to all States.<sup>4</sup>

*(e) Purpose for which guaranty letter is issued*

26. The Working Group was agreed that the definition of guaranty letter should not include the requirement that the guaranty letter state the purpose for which it was issued.

*(f) Undertaking in written form*

27. The prevailing view was that the question of the form of the guaranty letter should be dealt with not in the definition of guaranty letter, which was relevant for the substantive scope of the uniform law, but in an operative provision concerning the valid establishment of the guaranty letter.

28. Divergent views were expressed as to whether written form should be required. Under one view, written form was necessary to confirm the seriousness of the undertaking and to provide a credible and enforceable record thereof. The form requirement could be broadly defined so as to include electronic message equivalents or other means that served the above purposes. Under another view, the uniform law should be liberal and not itself impose any such restriction as to form, even though oral undertakings were hardly found in practice. However, following the approach adopted in the United Nations Convention on Contracts for the International Sale of

Goods (Vienna, 1980), individual States could be given the option of including the requirement when implementing the uniform law. As to the latter suggestion, it was pointed out that the wording of that Convention might have to be adjusted in view of the difference between a sales contract and a guaranty letter and that the mechanism of a reservation could be used only if the uniform law were eventually adopted in the form of a convention.<sup>5</sup>

29. The Secretariat was requested to prepare alternative draft provisions reflecting the two views. In so doing, it should consider the question of distinguishing between the original establishment of a guaranty letter and any later amendments, in view of the fact that amendments were at times made orally. Moreover, the draft provisions should address the additional issue of authentication.

*(g) Issued by a bank or other guarantor, at the request of a customer (principal, instructing or account party)*

30. The Working Group was agreed that the uniform law should cover not only guaranty letters issued by banks but also those issued by other institutions or persons. It was understood that that wide coverage would not interfere with any regulation of a State that prohibited certain institutions or persons from issuing guaranty letters. It was further suggested that the inclusion of guarantors other than banks should not imply that their expected standard of conduct could be different from that required for sound guarantee and letter-of-credit practice.

31. As regards the possible element that the guaranty letter be issued at the request of another person, concerns were expressed that this might be too narrow in that it might not be appropriate for counter-guarantees and for those exceptional cases where a guaranty letter was issued by an entity on its own behalf. It was agreed that in formulating the element of the customer's request an attempt should be made to alleviate those concerns.

32. The Working Group was agreed that the terms to be used in the uniform law for the various parties involved in guaranty letter operations had to be carefully chosen, taking into account the current usages in different parts of the world and the need to establish corresponding versions in the six official languages of the United Nations.

*(h) Payment to another party (beneficiary)*

33. The Working Group was agreed that the definition of "guaranty letter" should contain the element of payment "to another party", to be called "beneficiary".

34. In that connection, a suggestion was made that there were a number of other terms that should be defined in the uniform law, e.g., negotiation, transfer, assignment, document, to pay, to honour, letter-of-credit custom. The Working Group was agreed that it would consider that suggestion at a later stage.<sup>6</sup>

<sup>4</sup>See also discussion below, paras. 44-46.

<sup>5</sup>See also discussion below, paras. 103-106.

<sup>6</sup>See also discussion below, paras. 77-81.

### 3. Relationships to be dealt with in uniform law

#### (a) Relationship between guarantor and beneficiary

35. It was noted that the bulk of the operative provisions in the uniform law could be expected to deal with the rights and obligations of the guarantor and the beneficiary. It was stated, therefore, that the principle already enunciated that the uniform law should be restricted to only those elements that were strictly necessary to bridge the differences between legal systems was of particular relevance in this context. In respect of the relationship between the guarantor and the beneficiary, those elements would encompass such matters as the independence of the guarantor's obligation, irrevocability of the obligation, the time when the obligation was established, when it expired and a period of limitation within which claims could be brought under it.

36. Under another view, the uniform law might contain more detail than suggested above. It was pointed out that the purpose of the uniform law would be to unify the law. Whatever legal issues were not covered by the uniform law would be solved in practice by resort to other rules of national law that would not be uniform. It was suggested, therefore, that when the Secretariat prepared the first draft of the uniform law it should include more rather than fewer details. The Working Group might then decide to delete those provisions it did not believe were necessary.

37. The Working Group discussed the desirability of including in the uniform law a clear indication of the legal characterization of the guarantor's obligation. Under one view the uniform law should clearly indicate that the guarantor's obligation was of a contractual nature. One consequence of such a characterization would be that the guarantor would have no obligation until the beneficiary had accepted the terms of the guaranty letter.

38. Under another view, the uniform law should be drafted in such a way as to avoid the use of concepts. It was stated that a number of legal systems were currently not clear on the appropriate legal characterization to apply to the different relationships. As to the suggestion that the guarantor's obligation should be characterized as contractual in nature, it was said that such a characterization would cause problems in respect of the transfer to a third person of the beneficiary's rights under the guaranty letter.

39. Similarly, the Working Group decided that it was preferable not to attempt to determine the original source of the terms in a guaranty letter. It was noted that in many cases it was the beneficiary who determined the terms that it was willing to accept; it was the principal who instructed the guarantor as to what those terms would be, while it was the guarantor who issued the guaranty letter. If the original source of the terms was considered to be significant, it might be relevant to questions of interpretation of the guaranty letter as well as to the determination of the applicable law.

#### (b) Relationship between guarantor and principal

40. The Working Group noted that at its previous session the prevailing view had been that the guarantor's

relationship with the principal should be kept clearly separate from that with the beneficiary and as such should fall outside the scope of the uniform law (A/CN.9/316, para. 136). However, consistent with the decision made in respect of the relationship between the guarantor and the beneficiary, it was decided that when the Secretariat prepared the first draft of the uniform law it should include more rather than fewer details and that the Working Group might later delete those it did not believe were necessary.

#### (c) Relationship between guarantor and counter-guarantor

41. The Working Group confirmed its decision at its prior session that it would be appropriate for the uniform law to apply to the relationship between the guarantor and the counter-guarantor in view of the fact that that relationship was itself a guarantee relationship (A/CN.9/316, para. 135).

42. Although most of the issues in respect of the counter-guarantee were the same as those in respect of the principal guarantee, i.e., independence of the guarantor's obligation, irrevocability of the obligation, the time when the obligation is established, when it expires and the period of limitation within which claims could be brought under it, the counter-guaranty letter raised the specific issues of the possible right of the counter-guarantor to be subrogated to the rights of the guarantor and of the independence of the counter-guaranty letter from the principal guaranty letter. It was said that two different types of independence were involved: first, the counter-guarantor was obligated to pay only under the terms of the counter-guaranty letter it had issued. The terms of that guaranty letter might be quite different from the terms of the principal guarantee. For example, the principal guarantee might be accessory while the counter-guarantee was abstract. Secondly, the counter-guarantor did not review the documents against which the guarantor was paid; the counter-guarantee served the function of reimbursement of the principal guarantor.

43. Doubt was expressed in the Working Group as to whether there was ever a confirming bank on a guarantee, and therefore whether reference to such a party would be appropriate in the uniform law. It was noted, however, that the uniform law might also apply to some aspects of documentary credits, in which case reference to a confirming bank would be expected.

44. As on a previous occasion (see above, paragraph 24), a concern was expressed about the length of the period during which a counter-guarantee might be considered to be enforceable. It was noted that under the laws of some countries the guarantee, and therefore the counter-guarantee, was enforceable until the document representing the guarantee had been returned to the guarantor, which might lead to perpetual liability. In other cases the period of enforceability might be for a finite, but exceedingly long, period of time even though the guaranty letter stated a shorter period of time. Enforceability of guaranty letters for such long periods of time was said to raise problems with the banking regulatory authorities in some

countries where counter-guarantor banks were located. In addition, the capital adequacy rules under the Basel Agreement would increase the cost to counter-guarantor banks of remaining liable on the counter-guarantee.

45. It was suggested that those problems might be ameliorated if the uniform law were to contain a limit on the period that a guarantee, including a counter-guarantee, was enforceable. In reply it was stated that such an approach would not be effective; the uniform law could not be expected to be adopted by all States, or even all States of counter-guaranteeing banks. Therefore, those States that currently demanded guarantees that were enforceable for what was considered to be an excessively long period of time would always be able to require the principal who wished to secure the underlying contract to find a bank that would issue a counter-guarantee with the desired terms.

46. As one possible solution to the problem it was suggested that the uniform law might provide a cut-off period for the presentation of claims under a guarantee. The cut-off period would be effective unless the guarantee, including a counter-guarantee, were to provide for a longer period of time.

#### 4. *Restriction to international guaranty letters*

47. Under one view, the uniform law should be restricted to international guaranty letters. One reason given, which was not by itself determinative, was that the function of the Commission was to work towards the progressive unification and harmonization of international trade law. Of more immediate significance was that many legislators who might be prepared to adopt the uniform law if it was restricted to international transactions might not be prepared to adopt it if it was also applicable to domestic transactions. It was also pointed out that some of the eventual provisions might not be appropriate for domestic transactions, such as the definition of "money", which could be expected to refer to units of account.

48. It was suggested that in spite of those arguments it might be appropriate not to make a final decision on the requirement of internationality until the substantive provisions had been prepared. It was said that the essential elements of an independent guarantee were the same whether the guarantee transaction was domestic or whether it was international. Therefore, the substantive provisions when drafted might be acceptable by many States for domestic transactions. It was suggested that the substantive provisions might be more acceptable for domestic transactions if it was clear that the uniform law would not apply to consumer transactions.

49. In regard to the appropriateness for the Commission to prepare a uniform law that might be applied to domestic transactions, it was noted that the Commission's Working Group on the New International Economic Order had decided to prepare a model law on procurement that would apply to domestic as well as to international procurement. It had been the belief of that Working Group that that was the best method to harmonize the law governing international procurement.

50. It was suggested that the question whether the uniform law should be restricted to international guarantee transactions was of particular importance if the uniform law was eventually adopted in the form of a convention but that it would be of lesser importance if the uniform law was adopted in the form of a model law, since in that case any State would be free to adopt it for domestic guarantee transactions if it wished to.

51. When the Working Group turned to the possible criteria of internationality that might be applied if the sphere of application of the uniform law was so restricted, two sometimes conflicting policy considerations were stated. On the one hand, the application of the uniform law to a guaranty letter should be easily ascertainable to the banking and other personnel who would handle it. On the other hand, if at all possible the uniform law should be applicable to an entire guarantee relationship, including the principal guarantee and any counter-guarantees. The first of those policy considerations would call for the existence of the connecting criteria to be on the face of the guaranty letter itself. The policy would also be furthered if the recitals on the face of the guaranty letter were determinative of the application of the uniform law in respect of any party who had not participated in the placing of false recitals on the guaranty letter. The second of those policy considerations might call for investigation of facts that were not ascertainable from the face of the guaranty letter.

52. Support was given for the first three possible criteria set forth in paragraph 54 of the note by the Secretariat, i.e., (a) guarantor and beneficiary have their places of business in different States; (b) place of issue and place of business of requesting or instructing party (principal or counter-guarantor) are situated in different States; (c) place of issue and place of payment are situated in different States. It was also suggested that the three criteria might be set forth as alternative grounds for application of the uniform law.

53. It was pointed out that some possible criteria, such as the place of issue and the place of payment, might be irrelevant to the nature of the guarantee, and that in any case they could easily be manipulated. It was stated that in the typical four-party-guarantee relationship, e.g., a principal guarantee and a counter-guarantee, only the guarantor of the principal guarantee (beneficiary of the counter-guarantee) and the counter-guarantor would be from different States. As a result, if the criteria of internationality were restricted to the location or place of business of the guarantor and beneficiary, only the counter-guarantee would be subject to the uniform law.

54. Another suggestion was that a guaranty letter should be within the sphere of application of the uniform law if it was issued in connection with an international commercial transaction. In support it was stated that such internationality by reference was already known, especially in respect of international commercial arbitration where the internationality of the arbitration might be determined by the internationality of the relationship out of which the dispute arose. The question was raised as to how the personnel handling the guaranty letter could be expected

to know whether the underlying transaction was international. It was also suggested that such a criterion for the sphere of application might raise doubts about the independence of the guarantee from the underlying transaction.

55. Under another approach the uniform law should contain a general reference to internationality, accompanied by the three above criteria as examples. The courts would be left to determine whether other fact situations would be sufficiently international to bring the guaranty letter under the uniform law. In support it was said that such an approach would extend the uniform law to the maximum number of international guaranty letters. In reply it was said that the formula was too uncertain to be useful to the personnel handling guaranty letters.

56. The suggestion was made that under a principle of party autonomy the parties should be able to choose the application of the uniform law to the guaranty letter. It was stated in support that such a facility would in practical terms lessen the importance of any objective criteria of internationality. In response it was stated that legislators in many States would not welcome such an approach. It was noted, however, that the suggestion made above that the recitals in the letter of guaranty should be determinative of the facts therein for the purpose of determining whether the guaranty letter was subject to the uniform law had somewhat the same effect as permitting the parties to choose the application of the uniform law.

57. The Working Group requested the Secretariat to prepare alternative draft versions of a test of internationality, taking into account the above views and suggestions.

## B. Party autonomy and its limits

### 1. Express recognition of party autonomy

58. The question was raised whether it was necessary for the uniform law to state expressly that under the principle of party autonomy a guarantor could agree to give an independent guarantee. It was suggested that the existence of the principle and its application to the creation of an independent guarantee seemed to be self-evident. In reply it was said that an express statement to that effect in the uniform law would not be necessary today in many countries, especially in regard to independent guarantees given in connection with international transactions, but that that would not have been the case 10 years ago, when the idea of an independent guarantee was not well recognized. Even today there would undoubtedly be many States where the principle was not clearly recognized, and a clear statement in the uniform law would be useful.

59. It was noted that, although the principle of party autonomy would in general permit the creation of independent guarantees in international transactions, there may be hesitancy in some States to allow its full force in regard to some domestic transactions, and particularly in regard to some that were not commercial in nature. Furthermore, the principle of party autonomy as it might be set forth in the uniform law would not have the effect of overcoming

regulatory provisions of national law that prohibited certain entities from issuing independent guarantees or contained other special rules in that regard.

60. The principle of party autonomy would have the further effect of permitting the parties to an independent guarantee to deviate from those provisions of the uniform law that were not indicated to be of a mandatory character. It would be necessary to indicate at a later time which of the provisions of the uniform law were of a mandatory character and from which it would not be possible to deviate. It was suggested that two limitations on party autonomy that could already be envisaged went to the scope of application, i.e., that the parties to a domestic transaction could not bring themselves within the provisions of the uniform law by indicating that the transaction was international and that they could not set forth the terms of an accessory guarantee and make it an independent guarantee simply by using those words. It was noted, however, that in some countries a guarantee might be considered to be accessory unless the guaranty letter specifically stated that it was independent.

### 2. Possible reference to uniform rules and usages or customs

61. The Working Group was in agreement that the uniform law should not refer explicitly either to the Uniform Customs and Practice for Documentary Credits (UCP) or to the Uniform Rules for Guarantees (URG). It was noted that URG had not yet been agreed upon by the International Chamber of Commerce (ICC) and neither the final text nor the extent to which they would be used could be known at the present time. As for UCP, ICC had announced its intention to revise the current text. It was said that it would be inappropriate to refer in a legislative text of the nature of the uniform law to another text that was itself subject to periodic revision. It was, however, suggested that there might be reference to one or both in a preamble to the uniform law.

62. The Working Group was also in agreement that UCP and, potentially, URG were important compilations of the customs and practice in the field of independent promises. Furthermore, it was suggested, the very fact that UCP and URG could be more easily revised and brought up to date with the evolving banking practice than could the uniform law, a fact that had contributed to the undesirability to mention them by name in the uniform law, meant that it would be wise to restrict the substantive coverage of the uniform law to those matters that could not easily be covered by such compilations of banking practice as UCP and URG.

63. In reply it was noted that, while the space between the mandatory provisions of the uniform law and the provisions of the guaranty letter itself might be filled by UCP or URG, it might also be filled by provisions of national law other than those in the uniform law. Whether that space would be filled by provisions of national law other than the uniform law would depend in part on the coverage of UCP or URG and on whether either of those texts was applicable to the particular guaranty letter. In

that regard it was noted that, while there were a number of legal systems in which UCP would be applied by the courts as a matter of customary law, there were other legal systems in which it would be applied as a matter of contract and only if the parties incorporated it into the guaranty letter by reference. It was suggested by some that as a result it might be desirable for the uniform law to cover at least some of the same subject areas that were currently covered by UCP. The view was expressed that it would be desirable for there to be a high degree of co-ordination between UNCITRAL in its preparation of the uniform law and ICC in its revision of UCP and work intended to bring URG to completion.

64. The suggestion was made that, even if UCP and URG were not mentioned by name in the uniform law, the uniform law might make a reference to usages or custom, perhaps by the use of a formula modelled on article 9(2) of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980), which reads as follows:

“The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to the particular trade concerned.”

65. It was stated in reply that the formula used in the Sales Convention made sense in the context of the law of sales where the parties were completely free to draft their contract as they wished, but that it was not appropriate for use in the context of independent guarantees where many of the provisions of the uniform law would have an imperative nature.

### 3. Possible limits to party autonomy

#### (a) Limits set in mandatory provisions

66. The Working Group was agreed that party autonomy would be recognized in the uniform law within certain limits that should be clearly described by the law. As had been suggested at the twelfth session, the uniform law could establish certain standards of accountability and set forth the requirement of good faith. Such standards of accountability could be cast as limits to exemption clauses and, for example, impose liability on guarantors for failure to act in good faith or with reasonable care, as provided for in article 15 of the current draft URG.

67. In this connection, concerns were expressed that the uniform law might overlap or conflict with uniform rules prepared by ICC, in particular with UCP articles 15 and 16 on the issue of bank responsibility. In order to avoid undesirable inconsistencies, close co-operation between the two organizations was necessary. The observer of ICC explained the need and the organizational steps planned for a revision of UCP and expressed the expectation that the Commission would assist in those efforts, as it had done in connection with previous revisions.

#### (b) Exclusion of non-documentary conditions of payment

68. The Working Group considered the problem of non-documentary conditions of payment on the basis of the discussion set forth in the note by the Secretariat (A/CN.9/WG.II/WP.65, paras. 28-29 and 74-82). Various statements were made with a view to clarifying the scope of the problem.

69. It was pointed out that the problem under discussion concerned only conditions of payment and not any pre-existing conditions of effectiveness of the guaranty letter, and that it concerned only conditions in the strict sense of the word, that is, those that made payment dependent on an uncertain future act or event. It was noted that a demand or claim for payment could be considered to be documentary if made in written form, since the term “document” included any “writing”. In that connection, it was noted that different categories of “documentary guarantees” could be distinguished, depending on how many of the following payment conditions were stipulated: written demand, statement by beneficiary about principal’s default, specification by beneficiary of obligations not performed by principal, supporting documents by third party.

70. Finally, it was noted that the problem under discussion was different from that posed by a possible condition not set forth in the guaranty letter. Such an extraneous condition that might be agreed upon by the parties at a later stage raised different issues, such as the formal validity of amendments to the guaranty letter.

71. The crux of the problem under discussion was seen in the fact that non-documentary conditions of payment called for the determination or verification of facts and that such conditions might undermine the independent character of the undertaking to pay. While even the handling of documents was not always without difficulties, the need for factual determinations, which could be time-consuming, create difficulties or get the guarantor entangled in disputes between other parties, placed an undesirable burden on the guarantor and hindered the prompt payment under the guaranty letter. As expressed in the maxim “banks deal in documents and not in goods”, the documentary or representational character of the payment conditions was closely linked with the concept of independence.

72. It was noted that non-documentary conditions relating to the underlying transaction often cast doubt on the independent character of the undertaking and that it was a question of interpretation whether a given undertaking was in fact independent or accessory. While the uniform law could provide guidance by a rule of interpretation on that crucial issue, it was clear that an accessory guarantee would not be covered by the uniform law. Accordingly, the problem under discussion was, for the purposes of the uniform law, limited to those non-documentary conditions of payment that accompanied independent undertakings.

73. Various views were expressed as to the treatment of non-documentary conditions by the uniform law. Under

one view, the uniform law should not address the problem, let alone disallow such conditions or transform them into documentary conditions. It was stated, in support, that the agreement of the parties should be fully recognized and that strict compliance with agreed conditions was necessary for the sake of certainty. Moreover, the question of whether a non-documentary condition constituted an undesirable or unacceptable burden on the guarantor was a matter that should be left to the business judgement of the guarantor when assuming such an undertaking.

74. Under another view, the problem should not be addressed by a specific rule concerning non-documentary conditions but within the realm of a general rule that would provide sufficient discretion to deal in a practical way with the possible variety of cases. Such a rule could be one relating to strict compliance or one that defined the standard of care of a reasonable document checker in a bank.

75. The prevailing view, however, was that the uniform law should provide that non-documentary payment conditions be read as documentary conditions, unless, of course, the undertaking was not independent and thus fell outside the scope of the uniform law. While such conversion might be contrary to the expectation of one or more of the parties, that concern was expected to diminish over time with the parties' increasing familiarity with the relevant provision on conversion. As regards the mode of conversion, that is, which kind of document should be required, it was suggested that a statement by the beneficiary certifying the fact or event in question or, at his option, a certificate by an appropriate third person should suffice.

### C. Possible rules of interpretation

76. On the basis of the discussion set forth in the note by the Secretariat (paragraphs 83-99), the Working Group considered the ways in which the uniform law might provide guidance in the interpretation of the terms used in the uniform law and of the wording of guaranty letters.

#### 1. Definitions

77. The Working Group was agreed that the uniform law should define the essential terms used within the law. In formulating the definitions, due regard should be had to the terminology used in international guarantee and letter-of-credit practice and possible future changes. Thus, one should aim at establishing a clear common understanding without being excessively detailed or formalistic. In particular as regards UCP, it was suggested that definitional disparities between two internationally elaborated texts covering the same subject-matter should be avoided.

78. It was noted that the question as to which individual terms should be defined was difficult to answer at this early stage of the project. A final answer could be given only when it was clear which issues were covered and which operative rules were contained in the uniform law. Similarly, one could decide only at a later stage whether the definitions should be lumped together in provisions

placed in the first part of the uniform law or whether at least some definitions should be placed in the context of the substantive operative rules to which they primarily related.

79. A more far-reaching proposal was that the uniform law should contain a comprehensive compilation of terms that provided an authentic description of the practices in different regions and legal systems, based on national practice reports to be forwarded to the Secretariat. The purpose of the proposal was to ensure the national treatment of foreign guarantees and letters of credit by facilitating the comparative understanding of the characteristics of a foreign instrument and the essential rights and obligations of the parties (e.g., a financial stand-by letter of credit issued in the United States of America to be recognized and enforced in France, or a French guarantee to be confirmed by a bank in the United States). At a later stage, such compilation of terms might also provide a basis for developing abbreviated terms or symbols for electronic usage.

80. It was stated in reply that the proposal was too ambitious and could not appropriately be accommodated within the envisaged scope and purpose of the uniform law. Based on the experience gained by ICC in similar efforts, it was felt that insurmountable difficulties would be encountered in the implementation of the proposal.

81. The Working Group did not adopt the proposal. It was understood, however, that any national reports containing descriptive terms and practices that the Secretariat might obtain would be useful in preparing common and acceptable definitions of the terms to be used in the uniform law.

#### 2. General rules of interpretation

82. The Working Group considered possible general rules of interpretation that would apply to the whole uniform law, as suggested in paragraphs 84 to 86 of the note by the Secretariat.

83. The Working Group was agreed that the uniform law should contain a general rule, along the lines of article 3 of the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg), that would, for example, read: "In the interpretation and application of the provisions of this law regard shall be had to its international character and to the need to promote uniformity." Such a rule would help to eliminate or at least reduce reliance on traditional national concepts and thus to foster the aim of harmonization. It was stated that the incorporation of such a rule raised special considerations if the uniform law were adopted in the form of a model law rather than a convention.

84. The Working Group was agreed that the requirement of good faith should be included as a further general element of interpretation and that it could be combined with the above rule, as done in article 7(1) of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980): "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." It was noted in support that such a rule was also included in other texts elaborated by the Commission, such as the United Nations Convention on International Bills of Exchange and International Promissory Notes (New York, 1988) which, however, referred to "international transactions" rather than "international trade". On the latter point, it was agreed that the Working Group would select appropriate wording for the uniform law at a later stage, on the basis of alternative draft provisions to be prepared by the Secretariat.

85. It was further stated that the requirement of good faith as an element of interpretation was of particular importance in the subject-matter governed by the uniform law in that it could foster the observance of good faith by principals, beneficiaries and other parties involved in guarantee and letter-of-credit operations. It was pointed out that the inclusion of the element of good faith might have implications for the treatment of certain issues, such as manifestly abusive or unfair callings, and that those implications should be taken into account in the formulation of the operative provisions.

### 3. *Special rules of interpretation*

86. The Working Group considered possible special rules geared to the subject-matter governed by the uniform law. A first such rule would call for the strict construction of the terms and conditions of the guaranty letter. While there was agreement on the principle and the usefulness of such a rule, the discussion revealed various differences concerning its scope and meaning.

87. As regards the term "strict", linguistic differences were found to exist in that, for example, in civil law countries of the Romanistic tradition the term "literal" was commonly used, without necessarily being the precise equivalent of what in other jurisdictions was called "strict". Another source of uncertainty appeared to be the fact that the notion of "strictness" or "literality" related to various issues and accordingly conveyed different connotations.

88. A primary issue was the determination of the rights and obligations of the parties that had to be made solely on the basis of the terms and conditions set forth in the guaranty letter. The preclusion of reliance on any extraneous facts or intentions was of particular importance in the subject-matter governed by the uniform law since the need for verifying factors concerning the underlying relationship or the principal-guarantor relationship would undermine the independent character of the undertaking.

89. The commonly agreed restriction to what was within the four corners of the guaranty letter became especially relevant at the stage of performance or enforcement of the parties' obligations. In addition to the exclusion of extraneous facts or intentions, the strictness of the construction of individual terms found in the guaranty letter became particularly crucial. As exemplified by the doctrine of

strict compliance of documents, the question arose as to how strictly or literally individual requirements had to be met.

90. In this context, a terminological imprecision arose from the fact that "strict compliance", as distinguished from "substantial compliance", could be understood as meaning true strictness down to the comma or as allowing a marginal latitude to correct typographical errors or similar minimal deviations. As indicated by that example, the term "strict" or any equivalent single word seemed to be insufficient to describe precisely the standard of construction or compliance.

91. As regards the standard of construction to be generally applied, a suggestion was made that the understanding of bankers, based on their established practices, should be determinant. They were in the best position to judge the practical requirements of the day-to-day handling of many payment instruments and of maintaining smoothly functioning correspondent relationships in international transactions despite the current disparity of legal rules in different jurisdictions. In response, a concern was expressed that such a standard might accord a privileged status to one category of persons involved in guarantee and letter-of-credit transactions. That would be inappropriate if it went beyond the setting of a standard of reasonable conduct that, like any other standard of care, would be geared to the relevant group of persons (e.g., document checkers) and take into account the requirements of their practice.

92. As regards the strict or literal construction of an individual term in the guaranty letter, a concern was expressed that it would be inappropriate and too formalistic where other terms in that guaranty letter would suggest a different construction. For example, the use of the term "*cautionnement*" in a French guarantee should not preclude the characterization of the undertaking as independent based on terms and conditions set forth in the guarantee. It was noted, in response, that the principle of strict construction could not be understood as according more weight to one term than to another term used in the same text. In such cases of inconsistency or ambiguity, the principle of strict construction would be of no assistance and might have to be supplemented by more specific rules of interpretation.

93. As suggested in the note by the Secretariat (paragraph 94), one such rule that would address the problem of the above example would be to accord priority to the terms and conditions over any inconsistent label or legal characterization used in the same text. In support of such a rule, it was stated that it would help to disregard a legal characterization expressed by the parties in a label that was incorrect in that it was inconsistent with the terms and conditions that compelled a different characterization. Certainty about the legal characterization was needed not only for the determination of the substantive scope of application of the uniform law but also in a variety of practical contexts (e.g., a bank asked to issue a counter-guarantee needed to know the legal nature of the principal guarantee).

94. However, concerns were expressed that such a rule might be too rigid and too mechanical to give sufficient

leeway to the courts to decide the issue in the light of all the circumstances. It was also doubted whether such a special rule was appropriate in view of the fact that national laws tended to have general rules of interpretation that might provide for nullity or envisage other solutions for cases of ambiguity or inconsistency.

95. As regards the characterization of an undertaking as either independent or accessory, it was suggested that, if the legal nature could not be determined by any other general or special rule of interpretation included in the uniform law, the undertaking would in such case of doubt be regarded as independent. It was pointed out in support that the resolution of such doubt would be useful in view of the fact that the legal nature of the undertaking determined the substantive application of the uniform law and that uncertainty about the legal nature was a problem often encountered in practice. In support of a presumption in favour of independence, it was noted that that would accord with the needs and actual practice at the international level.

96. The suggestion was opposed on the ground that such a rule would be a novelty in an international legal text in that it would apply to instruments where doubts existed as to their legal nature and thus to their being covered by the uniform law, and that it would bring such instruments under the law's coverage by a rule of presumption in its favour. It was further pointed out that not all international guarantee undertakings were independent. Moreover, such a rule would be inappropriate in that it would favour the beneficiary to the detriment of the guarantor. On the latter point, it was stated in reply that the rule would serve the interest of the guarantor in that it provided certainty and spared him from having to ascertain or verify any facts relating to the underlying transaction. The Working Group agreed to reconsider and decide on the suggestion on the basis of a draft to be prepared by the Secretariat.

97. The Working Group considered the related suggestion of a general rule on solving ambiguities or inconsistencies, as set forth in the note by the Secretariat (paragraphs 90-92). Such a rule could either call for the construction of the text against the actual drafter or, if a clear-cut rule were preferred, construe the text against one of the parties, in which case a choice would have to be made between the guarantor and the beneficiary.

98. No support was expressed for a clear-cut rule that would favour either the guarantor or the beneficiary. It was felt that such a rule would be unfair in that it could operate to the detriment of a party who had not been involved in the drafting of the ambiguous language. If a rule were to be adopted, it should place the risk of ambiguity on the actual drafter of the text. It was stated in support that such a rule ("*contra preferentem*") was known in various national and international legal texts and that its operation, including the need for establishing the actual draftsmanship, appeared to function well. However, the rule was objected to on the ground that it required investigations of fact that were inappropriate in the context of independent undertakings. Moreover, the idea of construing an ambiguous text against its drafter, while reasonable as a general idea, should not be cast in terms of a rigid, mechanical rule.

99. The Working Group considered the suggestion set forth in paragraph 95 of the note by the Secretariat (and illustrated by three examples in paragraphs 96 to 98). The suggestion was to consider the advisability of including in the uniform law a rule of interpretation that would accord priority to a special, individual clause that was in conflict with a clause contained in standard clauses, general conditions or, possibly, uniform rules referred to in the same guaranty letter.

100. The Working Group was agreed that the principle underlying the suggestion was a sound one and that it was recognized in most national laws. However, it was felt that a strict and mechanical rule adopting that principle would be inappropriate for the uniform law.

101. In that context, a suggestion was made that the uniform law, assuming that it would cover commercial letters of credit, should accord priority to UCP, as referred to in almost every letter of credit, over any inconsistent provision of the uniform law. Such a rule of priority could refer to party autonomy or to universal customary law, if an express mention of UCP appeared undesirable. It was noted in reply that the suggestion related to issues that had been discussed earlier, namely, the possible limits to party autonomy and the advisability of avoiding conflicts between the uniform law and UCP (see, in particular, above, paragraphs 60, 66-67). It was stated that both issues were of continuing importance throughout the preparation of the uniform law and that the suggestion of according general priority to UCP could thus not appropriately be decided upon at the current stage of the preparatory work.

102. The Working Group adopted the proposal set forth in paragraph 99 of the note by the Secretariat that the uniform law should provide for the irrevocability of all undertakings covered by it unless otherwise stated in the guaranty letter. Such a provision would accord with the realities and needs of the international practice of guarantees and stand-by letters of credit and was preferable to current article 7 (c) of UCP which, in case of silence, treated letters of credit as revocable. A suggestion was made that in that connection consideration should be given to the problem of possible conditions of establishment or effectiveness.

#### D. Form and time of establishment of guaranty letter

103. The Working Group engaged in a preliminary exchange of views on issues relating to the form and time of establishment or effectiveness of a guaranty letter. It was pointed out that it was of utmost importance to guarantors and other parties to know exactly when a binding and irrevocable undertaking had been established. At the same time, it was realized that it would be difficult to find precise and uniformly acceptable solutions in view of the variety of means of communication and the diversity of current practices.

104. A suggestion was made that the search for acceptable solutions should be based on extensive empirical research and gathering of standard forms and actual guar-

antee texts from the various parts of the world. Such materials, to be forwarded to the Secretariat, would help to identify the essential formal requisites of guarantees and stand-by letters of credit on the basis of current international practices. In response, doubts were expressed as to the feasibility and actual benefit of such an extensive endeavour. While any information on current practices would be useful to the Secretariat, it was feared that the collection of information would be hampered by reasons of confidentiality. Above all, the information collected could be expected to reflect a large diversity of practices that were still in the process of development and that would change in the years to come. It was felt that any such compilation of current practices would thus not lead directly to solutions for the uniform law, especially when taking into account the possibility that some of the current practices might be regarded as unfair or unacceptable for other reasons.

105. As regards the required form of a guaranty letter, wide support was expressed for requiring some tangible or material form, to the exclusion of purely oral undertakings. In searching for an acceptable formula, regard should be had to the various means of communication that were currently used and to the rapid developments in the field.

106. As regards possible later amendments or modifications of the terms and conditions, it was suggested that the required form should be the same as that for the original establishment of the guaranty letter. It was stated in reply that there existed a practice under which an amendment of a written guaranty letter might be made orally and authenticated in that form. While the amendment would then be confirmed by a message in a form that provided a record of the amendment, the oral communication was in practice regarded as determining the point of time of effectiveness of the amendment.

107. As regards the question of the decisive point of time of the establishment of a guaranty letter, one view was that the guaranty letter should become binding and effective

when it was issued or released by the guarantor. Under another view, the guaranty letter should become effective when it was communicated to the beneficiary or accepted by it. It was stated that the decisive point of time depended on whether the undertaking was characterized as unilateral or contractual. While there was considerable support for the characterization as contractual, it was pointed out that some legal systems regarded the guaranty letter as a speciality of mercantile law, like the commercial letter of credit, where acceptance was usually implied from the silence of the beneficiary or effected by stipulations in advance.

### III. FUTURE WORK

108. The Working Group took note of the decision of the Commission at its twenty-second session that the fourteenth session of the Working Group would be held from 3 to 14 September 1990 at Vienna.<sup>7</sup>

109. The Working Group requested the Secretariat to submit to its next session a first draft set of articles, with possible variants, on the issues considered during the current session.

110. The Working Group further requested the Secretariat to submit to its next session a note discussing other possible issues to be covered by the uniform law. It was agreed that, of a number of detailed issues mentioned at the previous session,<sup>8</sup> the following issues should not be retained: preventing adverse effects of the submission of documents not called for under the terms of the guarantee; the risk of payment to an imposter, as regards both the right of reimbursement from the principal and any future claim by the true beneficiary; the beneficiary's warranty as to genuineness of documents; and measure of damages.

<sup>7</sup>Official Records of the General Assembly, Forty-fourth Session, Supplement No. 17 (A/44/V7), para. 297.

<sup>8</sup>A/CN.9/316, para. 173.

## B. Independent guarantees and stand-by letters of credit: discussion of some issues of a uniform law: substantive scope of uniform law, party autonomy and its limits, and rules of interpretation: note by the Secretariat<sup>a</sup>

(A/CN.9/WG.II/WP.65) [Original: English]

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<sup>a</sup>Working paper submitted to the Working Group on International Contract Practices at its thirteenth session.

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## INTRODUCTION

1. The Commission, at its twenty-first session, in 1988, considered the report of the Secretary-General on stand-by letters of credit and guarantees (A/CN.9/301). Agreeing with the conclusion of the report that a greater degree of certainty and uniformity was desirable, the Commission noted with approval the suggestion in the report that future work could be carried out at two levels, the first relating to contractual rules or model terms and the second pertaining to statutory law.<sup>1</sup>

2. With respect to the first level, the Commission welcomed the work undertaken by the International Chamber of Commerce (ICC) in preparing draft Uniform Rules for Guarantees and agreed that comments and possible recommendations by the States members of the Commission, with its balanced representation of all regions and the various legal and economic systems, could help to enhance the world-wide acceptability of such rules. Accordingly, the Commission decided to devote one session of the Working Group on International Contract Practices to a review of the ICC draft Uniform Rules for Guarantees in order to assess the world-wide acceptability of the draft Rules and to formulate comments and possible suggestions

that ICC could take into account before finalizing the draft Rules. The Commission also asked the Working Group to examine the desirability and feasibility of any future work relating to the second level as envisaged in the conclusions of the report, namely, the idea of striving for greater uniformity at the statutory level, through work towards a uniform law.

3. At its twenty-second session, in 1989, the Commission had before it the report of the Working Group on International Contract Practices on the work of its twelfth session (A/CN.9/316). The Commission noted that the Working Group had engaged in a review of the ICC draft Uniform Rules for Guarantees, as well as a discussion of the desirability and feasibility of achieving greater uniformity at the statutory level. The Commission also noted the recommendation of the Working Group that work should be initiated on the preparation of a uniform law, whether in the form of a model law or in the form of a convention.

4. After deliberation, the Commission decided that work on a uniform law should be undertaken. It entrusted this task to the Working Group on International Contract Practices and requested the Secretariat to prepare the necessary documentation.<sup>2</sup>

<sup>1</sup>Official Records of the General Assembly, Forty-third Session, Supplement No. 17 (A/43/17), paras. 19-24.

<sup>2</sup>Official Records of the General Assembly, Forty-fourth Session, Supplement No. 17 (A/44/17), paras. 236-244.

5. The present note constitutes the first part of a detailed discussion of possible issues of a uniform law. It covers essentially those topics and issues that the Working Group, based on a note by the Secretariat (A/CN.9/WG.II/WP.63), tentatively considered at its twelfth session under the headings "Possible scope of uniform law" and "Recognition of party autonomy for independent undertaking"; it also covers some of the issues dealt with under the heading "Strict construction and compliance" and some other possible issues that were mentioned at the twelfth session.<sup>3</sup> The Secretariat intends to cover the remaining issues, in particular those considered under the headings "Fraud and other objections to payment" and "Applicable law and related issues",<sup>4</sup> in a second discussion paper to be submitted to the Working Group at its fourteenth session (Vienna, 3-14 September 1990). Those issues, while closely linked with topics discussed in the present note, require especially careful preparation and in depth study in view of both the particular difficulties of harmonization efforts and the crucial importance of finding acceptable solutions in those areas.

6. The present note is designed to stimulate and aid the extensive deliberations by the Working Group that appear to be necessary before any draft provisions of a uniform law can usefully be formulated. It is based on the tentative considerations of the Working Group at its twelfth session. Where appropriate, reference is made to a pertinent provision in one of the few statutes dealing with independent guarantees or stand-by letters of credit, in the latest version of the ICC Draft Uniform Rules for Guarantees (URG)<sup>5</sup> or in the Uniform Customs and Practice for Documentary Credits (UCP; 1983 revision).<sup>6</sup>

7. The following discussion attempts to describe the selected issues and the relevant policy considerations in the light of current law and practice. It draws attention to those questions that need to be answered in order to provide the basis for the formulation of draft provisions. Even where not expressly noted, one basic question that needs to be kept in mind is whether or not a given issue or aspect thereof should be regulated in the uniform law. In a number of cases, this question will appropriately be answered only after extensive deliberation of the issue and of possible solutions.

## I. SUBSTANTIVE SCOPE OF UNIFORM LAW

8. The Working Group, at its twelfth session, reached a number of conclusions relevant to the substantive scope of the uniform law. Those conclusions pertain to the types of instrument to be covered, to the kinds of relationship to be dealt with and to the question whether the uniform law should apply to international instruments only.<sup>7</sup>

## A. Types of instrument to be covered

### 1. Focus on independent guarantees and stand-by letters of credit

9. The Working Group was agreed that the uniform law should focus on independent guarantees and, in view of their functional equivalence, on stand-by letters of credit. The Working Group was also agreed that the uniform law should be extended to traditional commercial letters of credit where that would be useful in view of their independent nature and the need for regulating equally relevant issues. Accessory guarantees are not to be covered, except perhaps in the context of a definition for the purpose of drawing a clear demarcation line between independent and accessory guarantees.

10. In conformity with that decision to focus on independent guarantees and stand-by letters of credit, it would be necessary to define those two types of instrument. Depending on the extent to which the uniform law would cover traditional commercial letters of credit, that type of instrument may later have to be defined. For the present purposes, and in view of the desirability of maintaining harmony with the UCP, it suffices here to reproduce the current version of the definition contained in article 2 as well as articles 3 and 4, which, while not forming part of the definition, express the independent and documentary nature of the undertaking:

#### "Article 2

"For the purposes of these articles, the expressions 'documentary credit(s)' and 'standby letter(s) of credit' used herein (hereinafter referred to as 'credit(s)'), mean any arrangement, however named or described, whereby a bank (the issuing bank), acting at the request and on the instructions of a customer (the applicant for the credit),

- i. is to make a payment to or to the order of a third party (the beneficiary), or is to pay or accept bills of exchange (drafts) drawn by the beneficiary, or
- ii. authorizes another bank to effect such payment, or to pay, accept or negotiate such bills of exchange (drafts),

against stipulated documents, provided that the terms and conditions of the credit are complied with.

#### "Article 3

"Credits, by their nature, are separate transactions from the sales or other contract(s) on which they may be based and banks are in no way concerned with or bound by such contract(s), even if any reference whatsoever to such contract(s) is included in the credit.

#### "Article 4

"In credit operations all parties concerned deal in documents, and not in goods, services and/or other performances to which the documents may relate."

<sup>3</sup>A/CN.9/316, paras. 124-139, 172-173.

<sup>4</sup>A/CN.9/316, paras. 147-171.

<sup>5</sup>ICC Document No. 460/364 and No. 470/584 of 18 October 1989.

<sup>6</sup>ICC Publication No. 400, reproduced in A/CN.9/251.

<sup>7</sup>A/CN.9/316, paras. 124-126, 134-136, 172.

11. While stand-by letters of credit are covered by the UCP (according to article 1, to the extent to which the articles may be applicable) and for that reason are said to be excluded from the URG,<sup>8</sup> the uniform law would use a different categorization and would treat them jointly with independent guarantees, based on their functional equivalence. In this vein, an attempt should be made to formulate a single definition that would cover both types irrespective of how they may be labelled.

12. One may even go a step further and adopt a common name for both types, e.g. "guaranty letter". Such a name could be used in the text of the uniform law without, of course, requiring that the individual guarantees and stand-by letters of credit be so named. An alternative drafting approach could be to use throughout the text the term "guarantee" and to define that term as including the stand-by letter of credit. For the purposes of the following discussion, the suggested common name "guaranty letter" will be used to refer jointly to independent guarantees and stand-by letters of credit.

## 2. Sample of current definitions

13. In preparing a suitable definition of "guaranty letter" for the future uniform law regard may be had to definitions found in legislation or uniform rules. To start with statutory definitions, there is only a very limited number of provisions from which guidance or inspiration may be drawn. As indicated in the report of the Secretary-General (A/CN.9/301, para. 57), few States have special statutory provisions on bank guarantees, indemnities or stand-by letters of credit.

14. Some of these laws cover in their definition both independent and accessory guarantees. For example, the 1963 International Trade Code of Czechoslovakia provides in section 665(1):

"Under a banking guaranty a bank (banking institution) undertakes to give satisfaction to the receiver of the guaranty (the entitled person) in accordance with the provisions of the guaranty, if a third party fails to execute his obligation or if the conditions specified in the guaranty are fulfilled."

This provision is said to cover both the accessory guaranty and the banking guaranty itself while another provision contains a special rule for so-called independent guaranties,<sup>9</sup> namely section 672, which reads:

"If the banking guaranty provides for the obligation of the bank to execute the secured obligation at the entitled person's first request and without objections, the bank may not raise objections against the entitled person, which would otherwise be available for the committer as debtor under the secured obligation against the entitled person."

<sup>8</sup>Statement of Observer of the ICC, A/CN.9/316, para. 19, and more recently expressed in the introduction to the latest draft of the URG: "Stand-by letters of credit cannot be governed by these rules since they are governed by UCP 400".

<sup>9</sup>Act No. 101 (of 4th December, 1963) on Legal Relations arising in International Business Transactions, Introduction and commentary by Kopač (Prague 1967), p. 200, 202.

15. Similarly, the 1978 Law of Obligations of Yugoslavia contains, in addition to a general definition (article 1084), a special rule for certain independent guarantees. Article 1087(1) reads:

"If the bank guarantee contains a clause 'no objection', 'first demand' or words of the same meaning, the bank may not raise against the beneficiary the objections which the principal could invoke as the beneficiary's debtor against the beneficiary on the basis of the guaranteed obligation."

16. The 1976 International Commercial Contracts Act of the German Democratic Republic contains the following definition in section 252:

"By a contract of indemnity one party (the party giving the indemnity) undertakes to the other party (the party to be indemnified) to effect payment up to the amount of the indemnity on the occurrence of the event contemplated by the contract."

The following two provisions, while not forming part of the definition, are also relevant for the characterization of the instruments covered:

"Sect. 253:

"Where the party to be indemnified claims the indemnity the party giving it is entitled to demand that he gives proof of the occurrence of the event contemplated by the contract.

Sect. 254:

Where the party giving the indemnity has done so on behalf of a third party, he may not assert any defences or claims available to such third party against the party to be indemnified."

While section 253 may appear to exclude independent guarantees that do not require proof, the commentary clarifies the non-mandatory character of the provision by stating that no proof would be required in the case of first-demand guarantees.<sup>10</sup>

17. Statutory definitions that focus on the independent guarantee are found in very similar form in the following States: Bahrain, Democratic Yemen, Iraq and Kuwait. For example, the 1980 Commercial Law of Kuwait provides in article 382:<sup>11</sup>

"A letter of guarantee is an undertaking issued by a bank, at the request of one of its customers (the person giving the instruction), to pay unconditionally a certain specified or determinable sum to another person (the beneficiary), if payment is requested within the time-period set in the letter; the letter of guarantee shall state the purpose for which it has been issued."

18. The definitions in the laws of the other three States are in substance the same, with the following exceptions. The 1987 Commercial Code of Bahrain (article 331) omits the word "unconditionally",<sup>12</sup> while the 1984 Com-

<sup>10</sup>Fincke, in: Kommentar zum Gesetz über internationale Wirtschaftsverträge — GIW — vom 5. Februar 1976, 2nd ed. (Berlin 1983), p. 359.

<sup>11</sup>Decree No. 68 of 1980 Enacting the Law of Commerce of Kuwait.

<sup>12</sup>Commercial Code of Bahrain, Law No. 7 of 1987.

mercial Code of Iraq (article 287) uses instead the expression "without any reservation" and adds to the above definition a separate rule (in article 293) that provides: "The beneficiary shall not claim the amount of the letter of guarantee for another purpose than that stated therein".<sup>13</sup> The 1988 Civil Code of Democratic Yemen contains (in article 1497) the above definition without the word "unconditionally" and adds the following rules on the validity period: "A letter of guarantee may be issued for an indeterminate period" and (in article 1500(2)) "If the letter of guarantee is valid for an unspecified period, its validity expires three years after the date on which it has been issued".<sup>14</sup> All four laws underline the independent character of the bank's undertaking by a provision along the following lines: The bank may not refuse payment to the beneficiary on grounds relating either to its relationship with the principal or to the relationship between the principal and the beneficiary.<sup>15</sup> The only exception is that the latter relationship is not mentioned in the Bahraini provision.<sup>16</sup>

19. As regards relevant definitions contained in uniform rules, it may suffice here to reproduce the current version of article 2 of the URG:

"a) For the purposes of these Rules a Guarantee means an undertaking by a bank, insurance company or other body or person (hereinafter 'the Guarantor') given in writing for the payment of money, subject to compliance with the terms and conditions of the Guarantee

- i) at the request, or on the instructions and under the liability of a Party (hereinafter called 'the Principal'); or
- ii) at the request, or on the instructions and under the liability of a bank, insurance company or any other body or person (hereinafter 'the Instructing Party') acting on the instruction of a Principal to another party (hereinafter the 'Beneficiary').

b) A Guarantee is independent of any underlying transaction and the terms of any such transaction shall not affect the Guarantor's rights and obligations under a Guarantee notwithstanding any reference thereto in the Guarantee. A Guarantor's obligation of performance under a Guarantee is to pay the sum or sums specified therein, subject to compliance with the terms and conditions of the Guarantee.

c) For the purpose of these Rules 'Counter-Guarantee' means the written undertaking of the Instructing Party to effect payment to the Guarantor in accordance with the terms of the Counter-Guarantee on receipt of the Guarantor's notification that it has been called upon to pay in accordance with the terms of the Guarantee.

The Counter-Guarantee is independent of the Guarantee itself and of any underlying transaction.

d) The expression 'writing' shall include an authenticated teletransmission or tested electronic data interchange ('EDI') message equivalent thereto."

20. The above sample of definitions should prove useful in identifying and discussing the possible elements of a definition of "guaranty letter" for the future uniform law. The following discussion of such elements will often be relevant also for later considerations in the drafting of operative provisions. However, one must clearly distinguish between a definition that delimits the substantive scope of application and an operative rule that regulates an issue of any instrument falling within that scope. For example, non-compliance with a requirement of form included in the definition would result in the non-application of the law. In that case the instrument might be subject to another law with different requirements that might favour its validity. On the other hand non-compliance with a mandatory requirement of form found in the operative rules would entail the sanction prescribed therein, such as invalidity.

### 3. Possible elements of a definition of "guaranty letter"

#### (a) Independent undertaking to pay

21. To start with the less difficult part of this central element, the "undertaking to pay" is certainly to be contained in the definition. The term "undertaking", or possibly "promise", seems preferable to expressions like "contract", "agreement" or "arrangement" in that it leaves open the controversial question of the legal characterization of the guaranty letter. At least, it does not positively characterize the guaranty letter as contractual, which would trigger the application of ordinary contract rules, even though the obligation may have come about in a different manner. The terminology would later have to be adjusted if, during the preparation of the operative provisions, it would become necessary to decide whether the guaranty letter constitutes a contract or, for example, a special creation of commercial law.

22. Considerably more difficult to deal with is the "independent" character of the undertaking to pay. This character constitutes the most essential common feature of the guarantees to be covered and the stand-by letters of credit as well as the traditional letters of credit, and the principle of independence will be an important theme underlying the preparation of the uniform law. While its precise meaning and scope will have to be determined in the context of various operative provisions, it must be expressed in the definition with sufficient clarity to distinguish between the guaranty letters covered by the uniform law and the accessory or secondary guarantees, bonds or suretyships not covered by it.

23. It seems very doubtful whether, for that purpose, a single word would suffice; not even the term "independent" seems to be sufficiently certain in its meaning and widely established. In fact, it invites, more than the similar term "autonomous", the question as to what the guaranty obligation is independent from. The answer given in some of the above definitions or separate rules is primarily the so-called underlying transaction (or guaranteed obligation) and often also the relationship between the guarantor (issuer) and the principal (customer, applicant, account party, instructing party).

<sup>13</sup>Commercial Code of Iraq, Law No. 30 of 1984.

<sup>14</sup>Civil Code of Democratic Yemen, Law No. 8 of 1988.

<sup>15</sup>Democratic Yemen: Sect. 1499; Iraq: Sect. 290; Kuwait: Sect. 385.

<sup>16</sup>Sect. 334.

34. Another question that should be considered is whether the amount payable must be specified in the guaranty letter and whether it must be definite or, at least, determinable, as provided for in some of the above statutory definitions. From a practical point of view, it is a reasonable requirement that the amount payable be specified. In fact, it seems highly unlikely that a guaranty letter would be issued without such specification, and to exclude such rare instruments from the scope of the uniform law would not appear to serve a useful purpose. Instead, consideration may be given to merely assuming such specification in wording such as "payment of amount specified in the guaranty letter" or, as found in article 16 URG, "a guarantor is liable up to an amount not exceeding that stated in the guarantee . . .". One might even be content with the appeal expressed in article 3 URG that "all Guarantees should stipulate: . . . (e) the maximum amount payable and the currency in which it is payable; . . . (h) any provision for reduction of the guarantee amount".

35. Special considerations may apply in respect of the possible requirement that the amount be definite or, at least, determinable. The expression "determinable" raises the question on what basis that determination would be made. This, in turn, raises the above general question of whether non-documentary conditions should be excluded (e.g. reduction of performance guarantee amount according to progress of construction without providing for documentary proof such as certificates of completion of defined stages of construction).

(d) *Claim within specified period of time*

36. It is an essential and obvious requirement that the claim or request for payment must be made within a specified period of validity or effectiveness. While this requirement may be included as an element in the definition, as done in some of the above statutory definitions, it should certainly be included in the operative rules on the guarantor's duties or the beneficiary's right to payment, as, e.g., in article 19 URG: "a claim shall be made in accordance with the terms of the Guarantee on or before its expiry . . .".

37. As regards the question as to whether a period of time has to be specified in the guaranty letter, similar considerations apply as those relating to the specification of the amount payable (see above, paragraph 34). Here, too, it would not seem appropriate to exclude from the scope of the uniform law those instruments that do not specify such a time-limit. Instead, consideration might be given to providing a solution for those instruments in a rule of interpretation taking into account the purpose of the given guaranty letter or in a suppletive rule that would fix the time-limit failing specification, as done in the Commercial Code of Democratic Yemen (see above, paragraph 18). Finally, as regards the possibility that an expiry event rather than a date may be specified in the guaranty letter, the general question becomes relevant here as to whether non-documentary conditions should be excluded.

(e) *Purpose for which guaranty letter is issued*

38. Inspired by the statutory definitions cited in paragraphs 17 and 18, consideration might be given to includ-

ing the requirement that the guaranty letter would have to state the purpose for which it had been issued. It has been pointed out in support of such a requirement that an instrument without any information about its purpose and its qualifying event cannot be properly described, for example, as a first demand guarantee. "It may be an ordinary debenture bond or a promissory note, depending on its actual wording. The statement in the instrument that it has been issued in respect of a certain contract or legal relation prevents its call to satisfy claims under other contracts or legal relations."<sup>18</sup>

39. If one were to follow that reasoning, it would seem appropriate to include the requirement in the definition so that instruments without specified purpose could be valid under other laws. However, one may doubt whether the requirement needs to be retained and expressed at all. Apart from the practical assumption that guaranty letters without any indication of their purpose are highly unlikely, the very requirement of stating the purpose might lead to the inclusion of language that could give the guaranty letter a less independent flavour than was in fact intended.

(f) *Undertaking in written form*

40. "Writing" constitutes an element of the definition in the URG and is explained in a separate part of the definition as including an authenticated teletransmission or tested electronic data interchange ("EDI") message equivalent thereto. The above statutory provisions, which do not expressly require written form, appear to have been formulated on the assumption that guaranty letters would be in writing. Either of the two approaches may be considered as appropriate for the uniform law.

41. Yet another approach could be to require written form in an operative rule, with the result that non-complying guaranty letters would be included in the scope of the law and they would be subject to the sanctions provided therein. If that approach were to be adopted, the definition of "writing" should be even broader and future-oriented than under the first approach, where it would form a requirement delimiting the scope of application.

42. If "writing" were to be defined in the uniform law, no terms should be used that are linked to particular technologies. A wide wording, inspired by the UNCITRAL Model Law on International Commercial Arbitration, would be, for example, "any transmission that provides a record of the text of the guaranty letter", and one may add "provided that it is authenticated [in an authorized manner]". One might even go so far as not to define "writing" but merely require and define "signature or other authentication".

(g) *Issued by a bank or other guarantor, at the request of a customer (principal, instructing or account party)*

43. The Working Group may wish to decide whether the uniform law should cover only those guaranty letters issued by banks, in which case it would need to find a uniform definition of the term "bank". Such a restriction

<sup>18</sup>Khalek Omar, *The regulation of international first demand bonds—a comparative approach*, 4 Arab L.Q. (1989), p. 103.



may, however, be inappropriate in view of the fact that stand-by letters of credit and guarantees are currently issued also by other institutions and persons and that future developments in that respect should be taken into account. As regards the term to be used throughout the uniform law for the institution or person issuing the guaranty letter, one may choose, for example, "guarantor" or "issuer".

44. As regards the fact that the guaranty letter is issued at the request of another person, it would not seem appropriate to require an indication in the guaranty letter of that request or of the requesting person, whether as an element delimiting the scope of application or as a requirement in an operative provision. However, the requesting person needs to be given a name for the purposes of the uniform law. In choosing a suitable term, regard must be had to the possible fact situations and, in particular, different relationships in more complex cases involving, for example, counter-guarantees syndicated guarantees or confirmed guarantees (see below, paragraphs 50-51). In this light, terms like "customer", "applicant" or even "account party" might not prove to be appropriate. The term "principal" might prove to be inappropriate for another reason, namely that it would not fit guaranty letters with a purpose other than to cover the risk of default of the debtor of an underlying transaction. A more neutral and wider term could be "instructing party" which is used in the URG only for an intermediate party. It may be noted that the present note still uses the terms used in earlier documents, i.e. principal, guarantor, counter-guarantor and beneficiary.

45. It may be added that in choosing appropriate terms due account must be taken of the need for establishing correspondent terms in the six official languages of the United Nations. The same applies to all other questions of terminology. It is submitted that the establishment of uniform terminology in those six languages would be of considerable practical value even beyond the uniform law in that it would help to overcome the current disparity and confusion.

#### (h) *Payment to another party (beneficiary)*

46. The definition of "guaranty letter" should contain the element that the guarantor's undertaking is to pay to another party. Following common usage, that party would be called "beneficiary" throughout the uniform law.

47. The definition would, however, not be the appropriate place for dealing with related issues such as the exact determination or identification of the beneficiary, the possible plurality of beneficiaries or the possible transfer of the status and rights of a beneficiary. Such issues should be dealt with, if at all, in operative provisions of the uniform law.

### **B. Relationships to be dealt with in uniform law**

#### *1. Relationship between guarantor and beneficiary*

48. The Working Group was agreed at its twelfth session that the uniform law could usefully describe the

essential rights and obligations of the parties to a guaranty letter; thus the relationship between the guarantor and the beneficiary would naturally be covered.<sup>19</sup> This relationship will be dealt with, in addition to the above discussion of the definition of "guaranty letter", in the bulk of the operative provisions. There, a general question will be into what detail the regulation of the essential rights and obligations of these two central parties should go.

#### *2. Relationship between guarantor and counter-guarantor*

49. As regards the relationship between guarantor and counter-guarantor, the Working Group deemed its inclusion appropriate in view of the fact that it was in substance a guarantee relationship.<sup>20</sup> This very fact suggests that the operative provisions of the uniform law should be drafted so as to apply to that relationship as well, unless otherwise stated in the provisions.

50. The definition of "counter-guarantor" might expressly include a consortium of counter-guarantors giving a syndicated guaranty letter. In formulating the definition and any special operative provisions due regard must be had to the fact that the counter-guarantor is liable solely to the guarantor, who is his "beneficiary", while the guarantor's beneficiary (the ultimate beneficiary) has no right to payment from the counter-guarantor.

51. The position of the counter-guarantor is in clear contrast to that of a confirming guarantor who, like a confirming bank under a traditional letter of credit, adds its own undertaking to that of the issuer with the result that both are liable to the ultimate beneficiary. Confirmed guaranty letters are probably rare. If they were to be covered by the uniform law, as they are, for example, by the Czechoslovak International Trade Code,<sup>21</sup> the definition of "confirming guarantor" or "confirmer" could be drafted parallel to that of "confirming bank" under a traditional letter of credit.

#### *3. Relationship between guarantor and principal*

52. While the prevailing view in the Working Group was that the guarantor's relationship with the principal should be kept clearly separate from that with the beneficiary and as such should fall outside the scope of the uniform law, it was agreed that reference to the principal would have to be made and that certain aspects of the guarantor-principal relationship might be covered.<sup>22</sup> As a first consequence, the position of the principal needs to be defined and the word used to designate him reconsidered (as suggested above, paragraphs 44). The question as to which aspects of his relationship with the guarantor might be covered will have to be answered in the context of par-

<sup>19</sup>A/CN.9/316, para. 134.

<sup>20</sup>A/CN.9/316, para. 135.

<sup>21</sup>Sect. 669(1) reads: "If, acting under the instructions of the bank, another bank confirms the guaranty of the former bank, the entitled person may assert his claims under the guaranty against any of these banks".

<sup>22</sup>A/CN.9/316, para. 136.

ticular operative provisions, such as those on the guarantor's duties and on possible measures of enjoining payment as well as in defining the scope of possible choice-of-law provisions.

### C. Restriction to international guaranty letters

53. When the Working Group considered whether the uniform law should cover only international guarantees and letters of credit or whether it should also include domestic instruments, a view was expressed that both types should be included since a distinction was neither easily drawn nor justified and since there was a need for improving the often unsettled laws in respect of domestic guarantees. The prevailing view, however, was that, in line with UNCITRAL's functions, the uniform law should be limited to international instruments, in particular, since inclusion of domestic instruments would adversely affect the world-wide acceptability of the uniform law.<sup>23</sup>

54. The Working Group may wish to consider the following variants of a possible test of internationality: (a) guarantor and beneficiary have their places of business in different States; (b) place of issue and place of business of requesting or instructing party (principal or counter-guarantor) are situated in different States; (c) place of issue and place of payment are situated in different States; (d) guaranty letter stipulates its treatment as international.

55. It may be noted that the above variants are designed to determine the international character of one given guaranty letter, which may or may not be part of a more complex guarantee network (e.g. principal in State A, counter-guarantor in State B, issuing guarantor and beneficiary in State C, confirming guarantor in State D). This limited focus seems necessary to facilitate the determination by those handling the instrument who may not know of other parts of the network or who may wish to make that determination before other parts have been created. However, in formulating the test of internationality regard should be had to the possibility of a complex network and to the desirability of a consistent determination for all its parts. Similar considerations apply to the different issues of the territorial scope of the uniform law and possible conflict-of-laws provisions to be discussed in a separate note.

56. As regards the above mentioned variants, it is submitted that variant (a) would be too narrow in that it would exclude those many guaranty letters with international set-up or flavour that are given to beneficiaries by local banks. In this respect variant (b) seems more appropriate in view of the likelihood that instructions are given by a foreign party, if it is a counter-guarantor; even where a principal turns to his local bank, the guaranty letter for a foreign beneficiary may be issued by a foreign branch of that bank or by another bank in the foreign country. Yet, since his local bank may also issue itself the guaranty letter for the foreign beneficiary, consideration may be given to combining variants (a) and (b) as alternative criteria of internationality.

<sup>23</sup>A/CN.9/316, para. 172.

57. The scope of international coverage could somewhat be widened by adding variant (c) which, standing alone, would be too limited in view of the infrequency of instances where the place of issue and the place of payment are situated in different States, except perhaps in the case of a confirming guaranty letter.

58. Finally, one may consider adding variant (d), provided that this criterion would as such be acceptable. This criterion, which could be regarded as an opting-in clause, may raise the question of the legal qualification of the guaranty letter of which the clause would form part. It is submitted, however, that admission of such clause would not necessarily require the qualification as contractual; one might consider following the philosophy of the United Nations Convention on International Bills of Exchange and International Promissory Notes that the Convention would be applicable to a holder who merely takes an instrument bearing the appropriate words.

59. It may be added that the suggested combination of all variants, while desirable in view of the width of international coverage, may create certain difficulties for those who need to determine the international character of the guaranty letter. In order to reduce such difficulties, one may provide that the places serving as connecting factors are relevant only if they can be ascertained from the text of the guaranty letter. It is submitted that the interests of those handling guaranty letters should be generally borne in mind in formulating the test of internationality as well as other provisions of the uniform law. Another general suggestion in respect of the test of internationality would be to ascertain from those States that wish to retain their current laws for domestic stand-by letters and guarantees which borderline between international and domestic instruments would be acceptable as preserving their interests.

## II. PARTY AUTONOMY AND ITS LIMITS

### A. Express recognition of party autonomy

60. The Working Group, at its twelfth session, was agreed that the recognition of party autonomy constituted an important principle for a future uniform law. Even without an express provision to that effect, the uniform law would by its very existence and regulation of independent undertakings recognize the freedom of the parties to establish, for example, an independent guarantee.<sup>24</sup>

61. While an express provision may thus not be necessary, it might provide the following advantages. In particular for jurisdictions where the principle of independence is not yet firmly established or where the freedom of independent undertakings is surrounded by uncertainty,<sup>25</sup> an express provision may have a salutary effect in that it would put the matter beyond doubt. This effect would be reinforced by the nature of the uniform law as a *lex specialis*, i.e. a special law prevailing over other laws of the given State as regards the matters covered by it.

<sup>24</sup>A/CN.9/316, para. 128.

<sup>25</sup>On the evolution of law recognizing independent guarantees, see A/CN.9/301, paras. 57-61.

62. An express provision recognizing party autonomy would also provide the more technical advantage of forming an appropriate base or context for dealing with the following two items tentatively considered at the twelfth session of the Working Group.<sup>26</sup> One item suggested for inclusion in the uniform law would be a reference to uniform rules and to usages or customs. Another item, on which the Working Group was agreed, is the need that the recognition of party autonomy be accompanied by a clear description of its limits. Both items deserve careful consideration, irrespective of whether the Working Group would favour an express provision recognizing party autonomy.

## B. Possible reference to uniform rules and usages or customs

### 1. Reference to specific sets of rules or to uniform rules in general

63. In favour of including in the uniform law a reference to the URG and the UCP it was noted that these two texts reflected the ongoing dynamism of banking and commercial practice, and that a reference in the uniform law could foster their harmonizing effect.<sup>27</sup> It could be regarded as a recognition of the different but complementing functions of law and of rules, as described by the Task Force on the Study of UCC Article 5 concerning the relationship between US letter-of-credit law and the UCP: "There is much wisdom in the dual scheme which has emerged by which rules of practice are articulated by a non-legislative body in intimate contact with the letter of credit industry, on the one hand, and statutory rules are of a more skeletal character. The two approaches complement one another and permit maximum flexibility without compromising basic concerns regarding the character of legal obligations, rights, and duties which are necessary to provide certainty and predictability. As a result, any revisions should preserve this balance, strengthening the foundational character of the statute and welcoming clarification of trade practices where appropriate."<sup>28</sup>

64. There are certain considerations that may militate against an express reference to the UCP and, it is submitted, even more so in respect of the URG. As pointed out by the above Task Force, future revisions of the UCP could possibly be unacceptable to the banking community of the country in question, and it is not beyond the realm of possibility that the UCP may expire or be replaced by another trade code or set of uniform rules; any reference must be so drafted as to permit this type of evolutionary growth.<sup>29</sup>

65. The Working Group may wish to take these possibilities into account in its preparation of a uniform law that is expected to be in force for decades to come. While the above possibilities might be viewed as remote as regards the UCP as an internationally accepted articulation of custom or practice, the situation is considerably different as regards the URG, not only because they are still in the preparatory stage but also because it would be premature to dare predict the extent of their future acceptance and thus their potential for harmonization.

66. As regards the UCP, two additional considerations may be taken into account, one relating to the scope of the uniform law and the other one relating to the legal character of the UCP. It is submitted that, despite the fact that stand-by letters of credit are currently governed by the UCP and not by the URG, the appropriateness of a reference depends on the extent to which traditional commercial letters of credit will be covered by the uniform law.

67. If a reference were to be included, care should be taken so as not to take a stand, or appear to take a stand, on the controversial issue of whether the UCP may be regarded as commercial usages, constituting a source of law, or whether they become effective only by agreement of the parties.<sup>30</sup> One approach may be to provide, along the lines of article 2(e) of the UNCITRAL Model Law on International Commercial Arbitration, that party autonomy includes the freedom of referring to the UCP and to deal in a separate rule with the applicability of usages or customs (see below, paragraphs 69-70).

68. Another approach could be not to mention the UCP expressly but to refer in general terms to uniform rules. That approach would not constitute an express endorsement of the UCP and might not achieve in full the desired fostering of their harmonizing effect. However, it would have the considerable advantage of taking care of the above general concerns about specific references to the UCP and the URG.

### 2. Reference to usages or customs

69. The Working Group may wish to consider including a reference to usages or customs, whether or not it were to decide to include a specific or general reference to uniform rules. A special reason for doing so may be seen in the controversial issue of the legal nature of the UCP. A more general justification may be seen in the fact that the uniform law covers a central area of commercial law where usages and customs are of particular relevance.

70. If the Working Group were in favour of including a reference to usages or customs, it may wish to use as a model article 9(2) of the United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980): "The parties are considered, unless otherwise agreed, to have impliedly made applicable to their contract or its formation a usage of which the parties knew or ought to have known and which in international trade is widely known to, and regularly observed by, parties to

<sup>26</sup>A/CN.9/316, paras. 129-130.

<sup>27</sup>A/CN.9/316, para. 130.

<sup>28</sup>An Examination of U.C.C. Article 5 (Letters of Credit), A Report of the Task Force on the Study of U.C.C. Article 5, presented to the Letter of Credit Subcommittee of the Uniform Commercial Code Committee of the American Bar Association's Business Law Section and the U.S. Council on International Banking, Inc. (1989; Chairman: Prof. J. E. Byrne), p. 15.

<sup>29</sup>*Idem*.

<sup>30</sup>A/CN.9/316, para. 130.

contracts of the type involved in the particular trade concerned". However, apart from the necessary adjustment of the wording to the guarantee context, the reference to the agreement of the parties may have to be modified so as not to qualify the guaranty letter as contractual (see above, paragraphs 21 and 58).

### C. Possible limits to party autonomy

#### 1. Limits set in mandatory provisions

71. Party autonomy would be granted or recognized by the uniform law within certain limits that should be clearly described by the law. As a result, the rights and obligations of the parties would follow from the terms of the guaranty letter, subject to the uniform law.

72. In technical terms, the limits would be set in mandatory provisions of the uniform law. As suggested at the twelfth session of the Working Group, careful consideration should be given in respect of each future provision as to whether parties would or would not be permitted to derogate therefrom.<sup>31</sup>

73. In substantive terms, such mandatory provisions may relate, for example, to the establishment and effectiveness of the guaranty letter, to the beneficiary's right to payment and the guarantor's corresponding obligations, to the expiry or termination of the guaranty letter, and to possible court measures. In those individual contexts consideration may be given to the suggestion, made at the twelfth session, that the uniform law could, for example, establish certain standards of accountability and set forth the requirement of good faith. Such standards of accountability could be cast as limits to exemption clauses and, for example, impose liability on guarantors for failure to act in good faith or with reasonable care, as provided for in article 15 URG. As regards the requirement of good faith, its inclusion as a generally limiting rule might be objected to as undermining the independent nature of the guaranty letter and the doctrine of strict compliance.<sup>32</sup> However, its inclusion in individual contexts would be less objectionable, and even less so would be its inclusion in a rule of interpretation (see below, paragraph 86).

74. Yet another suggestion as to general limits was to disallow those variations that would undermine the fundamental nature of the undertaking. One concrete proposal in this respect was to exclude non-documentary terms and conditions of payment. As noted in the discussion of the independent undertaking to pay (see above, paragraphs 28-29), the problem of non-documentary conditions of payment does not lend itself to an easy and satisfactory solution. The problem was discussed in depth by the US Task Force on the Study of UCC Article 5 and the following discussion relies in part on the report of that Task Force.<sup>33</sup>

## 2. Exclusion of non-documentary conditions of payment

### (a) Scope of problem

75. A non-documentary condition of payment makes the beneficiary's entitlement under an established guaranty letter dependent on the occurrence of an uncertain future event. As indicated earlier (see above, paragraph 28), the guarantor would thus have to undertake a factual determination that may be time-consuming, create difficulties and get him involved in a dispute between other parties. The burden placed on guarantors who might have to determine difficult factual issues in a variety of transactions would adversely affect the swiftness and certainty of payment.

76. An important distinction needs to be drawn in view of the fact that non-documentary conditions of payment often pertain to acts or omissions in the underlying transaction. Where the right to claim payment is conditioned, for example, upon the principal's non-performance and not on a statement by the beneficiary or a third person certifying such default, the guarantor's undertaking would not be independent and would therefore fall outside the scope of the uniform law. For the purposes of the uniform law, unlike the law in the United States where it tends to be outside the authority of a bank to issue an accessory guarantee, raising the spectre of unenforceability,<sup>34</sup> the problem of non-documentary conditions of payment is thus reduced to those instances where the guarantor's undertaking is to be judged as independent.

77. Whether a given undertaking is to be judged as independent or as accessory is a preliminary and separate question. As regards an undertaking accompanied by a non-documentary payment condition, the answer is particularly difficult since the underlying policy considerations are in essence very similar to those that underlie the distinction between the documentary or representational level, on which letter of credit law operates, and the level of factual determination with its burdens and difficulties.

78. However, the two demarcation lines are not identical and non-documentary conditions may be found in independent undertakings to pay, whether included by intent or by inadvertence. For example, the amount payable, including its possible reduction, may have to be determined on the basis of a particular act or event. The same may be true in respect of the expiry or termination of a guaranty letter, unless a time-limit is set exclusively by a fixed date or documented event. It might even be true in cases where the non-documentary condition relates to the commercial object of the guaranty letter, for example, where the funds to be drawn under a stand-by letter of credit are to be used and disbursed by the beneficiary as supplement funds to complete a specific construction project.<sup>35</sup>

79. Before looking at possible solutions to the problem of non-documentary payment conditions, it may be added that certain acts or events do not create the burden of

<sup>31</sup>A/CN.9/316, para. 129.

<sup>32</sup>E.g. Harfield, *Identity Crises in Letter of Credit Law*, 24 *Arizona L.R.* (1982), p. 239, 254.

<sup>33</sup>*Supra*, note 28, p. 2-6.

<sup>34</sup>*Supra*, note 28, p. 5.

<sup>35</sup>*United States v. Sun Bank of Miami*, 609 F. 2d 832 (5th Cir. 1980).

difficult factual investigations. For example, where a guaranty letter stipulates, as a mode of performance, presentation at the counters of a given branch, the fact of compliance can be readily ascertained. Accordingly, the scope of the problem under discussion may be refined by excluding those acts or events that are readily ascertainable or easily verifiable as falling within the normal purview of the guarantor's clerks.

(b) *Possible solutions*

80. The Working Group may wish to consider the following three possibilities of dealing with non-documentary conditions in the uniform law, whether in a general provision or in individual contexts (e.g. amount payable and expiry). The first possibility would be to disallow such conditions and to ignore them if they nevertheless occur. That approach would deter their inclusion most effectively and satisfy the expectations of the parties regarding the independence and integrity of the guaranty letter. However, it may be regarded as too radical in that it may frustrate certain intentions of the parties by ignoring part of the text of the guaranty letter.

81. The second possibility would be to recognize and enforce the non-documentary condition, despite the above concern that it may adversely affect the swiftness and certainty of payment. That approach may be favoured on the ground that a guaranty letter should be enforced in accordance with its terms unless there is a compelling reason not to enforce a particular condition. It could also provide an incentive to guarantors not to use such conditions so as to avoid adverse consequences. Yet, it may be viewed as not solving the problem because it does not preclude the appearance of undesirable conditions that require a factual determination.

82. The third possibility would be to treat the non-documentary condition as a documentary condition. That approach may be viewed as a middle path that avoids to a large extent the disadvantages of the first two approaches. While such conversion into a documentary condition may be contrary to the expectation of one or more of the parties, the problem may be expected to disappear over time with the parties' increased familiarity with the relevant rule of conversion in the uniform law. As regards the possible details of such a rule, the uniform law could provide, for example, that a non-documentary payment condition be construed as being satisfied by a statement of the beneficiary certifying the occurrence of the event in question or, possibly at the option of the beneficiary, by a certificate of an appropriate third person.

### III. POSSIBLE RULES OF INTERPRETATION

83. The Working Group may wish to consider ways in which the uniform law may provide guidance in the interpretation of the wording of guaranty letters, including any reference to uniform rules, and of certain terms used in the uniform law. As regards the possible definition of terms, e.g. "independent undertaking", "money", "document", "establishment" or "issue" of guaranty letter, "writing" or "signature" or "authentication", "expiry" and "termina-

tion", the need and possible content of such definitions may best be discussed in the context in which they first appear. At that stage, a common understanding should be established so as to ensure the consistent use of each term throughout the uniform law. It is submitted that generally agreed definitions may have a salutary effect beyond the application and interpretation of the uniform law in that they may help to reduce the terminological disparity and confusion currently encountered in law, rules and practice.

84. As regards possible rules of interpretation, a final stand may appropriately be taken only upon agreement on the content of the operative provisions of the uniform law. Nevertheless, a tentative discussion may already here be useful, in particular, as regards possible rules of interpretation that would apply to the whole uniform law and should thus be taken into account when preparing the operative provisions.

85. A first rule of such general nature could be modelled on article 3 of the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg) and, for example, read: "In the interpretation and application of the provisions of this Law regard shall be had to its international [character] [origin] and to the need to promote uniformity". If the Working Group were in favour of such a rule designed to eliminate reliance on traditional national concepts, it may wish to consider the appropriateness of extending the rule to cover also the interpretation and application of uniform rules such as the UCP.

86. As mentioned earlier (see above, paragraph 73), the requirement of good faith might be adopted as another, probably additional, standard of interpretation. If acceptable, it could be combined with the first rule, as done in article 7(1) of the United Nations Convention on Contracts for the International Sale of Goods: "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".

87. A somewhat more specific rule geared to the nature of guaranty letters would be to call for the strict construction of the terms and conditions of the guaranty letter. While such a rule might be regarded as an essential operative provision and not as a rule of interpretation in the strict sense, it invites consideration of possible rules of interpretation for those cases where terms and conditions are ambiguous or inconsistent and thus provide obstacles to strict construction.

88. An ambiguity or uncertainty may exist in respect of a given term (e.g. payment upon "showing" of default) or in respect of various terms and conditions that reflect different intentions or are in conflict with one another (e.g. first demand guarantee given as security for the due performance of specified contract). Such doubtful terms may relate to any issue covered in a guaranty letter, including the crucial question as to whether the undertaking is independent and thus covered by the uniform law. As to this latter question, consideration may be given to providing guidance in determining whether an undertaking that refers to an underlying contract or states its commer-

cial purpose would fall under the earlier discussed definition of "independent undertaking" (see above, paragraphs 22-26) or whether it would fall outside the scope of the uniform law as an accessory guarantee or suretyship.

89. As a first aid in interpreting the terms and conditions one might construe them according to the guarantor's intent where the beneficiary knew or could not have been unaware what that intent was, otherwise according to the understanding that a reasonable person of the same kind as the beneficiary would have had in the same circumstances. While the suggested wording is inspired by paragraphs (1) and (2) of article 8 of the United Nations Convention on Contracts for the International Sale of Goods, the following rule found in its paragraph (3) would not seem appropriate in the guaranty letter context, at least not in full: "In determining the intent of a party or the understanding a reasonable person would have had, due consideration is to be given to all relevant circumstances of the case including the negotiations, any practices which the parties have established between themselves, usages and any subsequent conduct of the parties". The Working Group may wish to consider whether any described circumstances, e.g. established practices or subsequent conduct, or other transactional facts could be used as criteria of interpretation without undermining the principles of independence and of strict construction or literalism.

90. Where an ambiguity or inconsistency remains, a solution offered in the uniform law would be beneficial in view of the current disparity in statutory and case law. For example, where the legal nature of an undertaking is in doubt, it appears that French and Swiss courts would favour the obligor and regard the undertaking as accessory or secondary,<sup>36</sup> while courts in the United States tend to favour the beneficiary by construing the undertaking against the drafter (*contra proferentem*) as independent.<sup>37</sup>

91. The latter rule of interpretation might be considered as a possible uniform solution in view of the fact that the principle is known also in other legal systems, even though it may be limited to general conditions and standard contracts (e.g. Art. 1370 Italian Civil Code). However, the rule poses a dilemma in view of the fact that the terms of the guaranty letter are often drafted not by the guarantor/issuer but by the applicant/principal or by the beneficiary or even by non-parties such as governmental bodies or trade associations. In those cases, it may be unfair or at least unrealistic to tar the guarantor with the label of having drafted the ambiguous terms. If one were therefore to take the rule literally and not equate the guarantor with the drafter, one would permit or even require guarantors as well as courts to delve into the underlying or other relationships and investigate who in fact drafted the ambiguous language at issue. Such investigation, which may itself involve obscure facts and disputed issues, detracts from the role of the guaranty letter

as a swift and certain payment undertaking independent of other transactions.<sup>38</sup>

92. The latter difficulties may lead to a consideration of the appropriateness of a clear-cut rule that would have the advantage of easy application. If, for the sake of certainty, one were to adopt a rigid solution for all ambiguities, the choice would be to favour either the beneficiary or the guarantor. The choice is obviously a very difficult one in view of the different interests of those two parties and the need of taking into account also the principal's interests. To mention only one consideration in support of favouring the beneficiary, a rule of construing ambiguities against the guarantor may be justified on the ground that the terms of the guaranty letter are often drafted by the guarantor and, where that is not the case, the very rule would probably stimulate guarantors to pay attention and get involved in an effort to avoid ambiguous terms in the guaranty letters they issue.

93. If such a general rule of interpretation against the guarantor or against the beneficiary were to be adopted, the following two rules for special cases of inconsistencies should be given priority over the general rule. Even if no such general rule were to be adopted, they seem worthwhile considering as possible guides in interpretation on their own merits.

94. A first rule could help to overcome any inconsistency between the label or legal characterization of an undertaking and the terms or conditions by according priority to the terms and conditions. For example, where the expression "simple demand guarantee" is used in the heading or in the context of the undertaking ("to pay against beneficiary's simple demand"), it would be disregarded if one of the terms requires, for example, presentation of an engineer's statement certifying default. Another example could be to disregard the label "*cautionnement*" or "*cautionnement solidaire*" in a French guarantee text which otherwise leaves no doubt as to the independent nature of the undertaking.<sup>39</sup> The appropriateness of such a rule may be less clear where the terms or conditions that would prevail are found in printed standard clauses or in general conditions or rules referred to in the text.

95. Here, a second rule may be of assistance that would accord priority to special, individual clauses. For example, a clause contained in a rider would prevail over obviously pre-printed standard clauses to which it has been added. The same would apply to a clause in the text of the guaranty letter that is in conflict with a clause found in general conditions referred to in the guaranty letter. The Working Group may wish to consider whether the same should apply in cases where a clause is in conflict with an article of uniform rules referred to in the guaranty letter. Three examples may assist in the consideration of this complex matter.

96. Where a performance guarantee subject to the 1978 ICC Uniform Rules for Contract Guarantees (ICC Publication No. 325) stipulates payment against simple de-

<sup>36</sup>E.g. *Cour de Cassation*, 2 February 1988, referring to Article 1162 French Civil Code; *Kronauer*, Guarantees and Guarantee-like Indemnities under Swiss Law, 3 Int. Bank. L. (1985), p. 124.

<sup>37</sup>*Supra*, note 28, p. 16.

<sup>38</sup>*Supra*, note 28, p. 17.

<sup>39</sup>Cf. *Wollan/Pomerantz*, The Impact of Loss Commutations on Letters of Credit, 4 Letter of Credit Report (Sep/Oct 1989), p. 8.

mand, the above suggested rule would entitle the beneficiary to payment upon simple demand, despite the fact that article 9 of the Uniform Rules requires "either a court decision or an arbitral award justifying the claim, or the approval of the principal in writing to the claim and the amount to be paid".

97. Where a stand-by letter of credit, issued subject to the UCP, provides for payment within one business day upon presentation of the claim and specified documents, the above rule would give effect to that time-limit irrespective of whether one day were to be regarded as "reasonable time" in the terms of article 16(c) UCP.

98. Where a guaranty letter that incorporates the URG contains a cancellation clause or otherwise indicates that it is revocable, the above rule would uphold the revocable nature of the undertaking, despite the fact that, under article 5 URG, all guarantees and counter-guarantees are irrevocable. It may be added that the effect of article 5 is

not clear in that it may be interpreted either as excluding revocable guarantees from the scope of the URG or as disallowing them. In the first case, one may conclude in the above example that the whole URG would not be applicable; in the latter case, an additional uncertainty arises in that article 5 does not say whether the sanction is, for example, invalidity of the guaranty letter or conversion into an irrevocable undertaking.

99. In the light of these uncertainties, consideration may be given to providing in the uniform law that the undertakings covered by it are irrevocable unless otherwise stated in the guaranty letter. Such a rule would differ from that applicable to stand-by letters of credit governed by the UCP which treat letters of credit that are silent on that point as revocable (article 7(c)). If adopted in the uniform law, it would prevail over the UCP provision. It is submitted that such a rule favouring irrevocability is sound in view of the fact that, from a commercial point of view, a revocable guaranty letter remains a rare exception.

## V. LEGAL ISSUES OF ELECTRONIC DATA INTERCHANGE

Electronic data interchange: preliminary study of legal issues related to the formation of contracts by electronic means: report of the Secretary-General  
(A/CN.9/333) [Original: English]

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### INTRODUCTION

1. The Commission at its seventeenth session in 1984 decided to place the subject of the legal implications of automatic data processing to the flow of international trade on its programme of work as a priority item.<sup>1</sup> It did so after consideration of a report of the Secretary-General

<sup>1</sup>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. 136.

on the Legal Aspects of Automatic Data Processing<sup>2</sup> which identified several legal issues, namely those of the legal value of computer records, the requirement of a writing, authentication, general conditions, liability and bills of lading.

2. At its eighteenth session in 1985, the Commission had before it a report by the Secretariat on the Legal Value of Computer Records (hereinafter referred to as "the 1985

<sup>2</sup>A/CN.9/254.



report").<sup>3</sup> This report came to the conclusion that, on a global level, there were fewer problems in the use of data stored in computers as evidence in litigation than might have been expected. It noted that a more serious legal obstacle to the use of computers and computer-to-computer telecommunications in international trade arose out of requirements that documents be signed or that documents be in paper form. After discussion of the report, the Commission adopted the following recommendation:

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

*"Noting that the use of automatic data processing (ADP) is about to become firmly established throughout the world in many phases of domestic and international trade as well as in administrative services,*

*"Noting also that legal rules based upon pre-ADP paper-based means of documenting international trade may create an obstacle to such use of ADP in that they lead to legal insecurity or impede the efficient use of ADP where its use is otherwise justified,*

*"Noting further with appreciation the efforts of the Council of Europe, the Customs Co-operation Council and the United Nations Economic Commission for Europe to overcome obstacles to the use of ADP in international trade arising out of these legal rules,*

*"Considering at the same time that there is no need for a unification of the rules of evidence regarding the use of computer records in international trade, in view of the experience showing that substantial differences in the rules of evidence as they apply to the paper-based system of documentation have caused so far no noticeable harm to the development of international trade,*

*"Considering also that the developments in the use of ADP are creating a desirability in a number of legal systems for an adaptation of existing legal rules to these developments, having due regard, however, to the need to encourage the employment of such ADP means that would provide the same or greater reliability as paper-based documentation,*

1. *Recommends to Governments:*

(a) to review the legal rules affecting the use of computer records as evidence in litigation in order to eliminate unnecessary obstacles to their admission, to be assured that the rules are consistent with developments in technology, and to provide appropriate means for a court to evaluate the credibility of the data contained in those records;

(b) to review legal requirements that certain trade transactions or trade related documents be in writing, whether the written form is a condition to the enforceability or to the validity of the transaction or document, with a view to permitting, where appropriate, the transaction or document to be recorded and transmitted in computer-readable form;

(c) to review legal requirements of a handwritten signature or other paper-based method of authentication on trade related documents with a view to permitting,

where appropriate, the use of electronic means of authentication;

(d) to review legal requirements that documents for submission to governments be in writing and manually signed with a view to permitting, where appropriate, such documents to be submitted in computer-readable form to those administrative services which have acquired the necessary equipment and established the necessary procedures;

2. *Recommends to international organizations elaborating legal texts related to trade to take account of the present Recommendation in adopting such texts and, where appropriate, to consider modifying existing legal texts in line with the present Recommendation.*"<sup>4</sup>

3. This recommendation was endorsed by the General Assembly in resolution 40/71, paragraph 5(b), of 11 December 1985 as follows:

*"The General Assembly,*

*... Calls upon Governments and international organizations to take action, where appropriate, in conformity with the Commission's recommendation so as to ensure legal security in the context of the widest possible use of automated data processing in international trade;*  
..."<sup>5</sup>

4. At its nineteenth and twentieth sessions (1986 and 1987, respectively), the Commission had before it two further reports on the legal aspects of automatic data processing,<sup>6</sup> which described and analysed the work of international organizations active in the field of automatic data processing.

5. At its twenty-first session (1988), the Commission considered the proposal to examine the need to provide for the legal principles that would apply to the formation of international commercial contracts by electronic means and particularly through the medium of visual display screens. It was noted that there currently existed no refined legal structure for the important and rapidly growing field of formation of contracts by electronic means and that future work in that area could help to fill a legal vacuum and to reduce uncertainties and difficulties encountered in practice. The Commission requested the Secretariat to prepare a preliminary study on the topic.<sup>7</sup>

6. At the twenty-second session (1989), it was decided that a preliminary report would be submitted by the Secretariat to the twenty-third session of the Commission.<sup>8</sup>

7. It may be noted that in prior reports to the Commission and in the reports of the Commission, the subject has

<sup>4</sup>Official Records of the General Assembly, Fortieth Session, Supplement No. 17 (A/40/17), para. 360.

<sup>5</sup>United Nations Commission on International Law Yearbook, 1985, vol. XVI, Part One, D. (United Nations publications, Sales No. E.87.V.4).

<sup>6</sup>A/CN.9/279 and A/CN.9/292.

<sup>7</sup>Official Records of the General Assembly, Forty-third Session, Supplement No. 17 (A/43/17), paras. 46 and 47.

<sup>8</sup>Official Records of the General Assembly, Forty-fourth Session, Supplement No. 17 (A/44/17), para. 289.

<sup>3</sup>A/CN.9/265.

been considered under the general heading of "automatic data processing" (ADP), which was the term generally used to describe the use of computers for business applications. In recent years, the terminology generally used has changed to "electronic data interchange", especially in the context of the computer-to-computer movement of business information by telecommunications. Throughout the remainder of this report, the term "electronic data interchange" or its acronym "EDI" will be used.

8. A typical application of EDI is the exchange of commercial data in a bilateral relationship between trading partners. It can be realized either by a direct connection between computers of the communicating parties or through the intermediary computer of one or more third party service providers. One significant characteristic of EDI is that the data being communicated is structured into standard formats, permitting the data to be exchanged and processed in the receiving computer without being re-keyed. As international standards have been adopted and are increasingly used for computer network architectures and EDI message formats, the data can be transmitted irrespective of the particular hardware or software used at either end of the transmission.

9. The present report, which constitutes a preliminary and non-exhaustive study on the topic, serves three purposes: the first is to update some of the information initially given about ADP in the 1985 report; the second is to describe briefly some of the legal issues that are related to the formation of contracts by electronic means; the third is to outline some of the solutions that have been or are currently being developed for the purpose of accommodating EDI in the law of contracts. Where necessary, consideration is given to some legal issues that are not strictly linked to the formation of contracts. For example, such issues as the form of invoices (see paragraphs 28 and 40 below) arise from the implementation of contracts formed by electronic means. Nevertheless, they must be addressed in this study as a consequence of their possible impact on the increased use of EDI.

## I. THE REQUIREMENT OF A WRITING

### A. General remarks

10. Legal rules in many States require certain transactions to be concluded in writing. In the 1985 report that led to the adoption of the above stated UNCITRAL recommendation, the requirement of a writing in national statutes as well as in certain international conventions on international trade law was identified as one major obstacle to the increasing use of EDI. Some of those national statutes are mentioned in the 1985 report<sup>9</sup> and in the TEDIS study (see paragraphs 32 to 41 below).

11. In general, it can be noted that, where the requirement of a writing is contained in contract law, it may have one of three consequences. In one situation, a writing is required as a condition to the existence or the validity of the legal act it bears. Consequently, the non-existence of

a writing entails the nullity of the legal act. In a second situation, a writing is required by law for evidentiary purposes. A contract of that kind can be validly concluded by the parties without a writing being required, but the enforceability of the contract is limited by a general rule that requires the existence and contents of the contract to be evidenced by a writing in case of litigation. Some exceptions to that rule may exist (see paragraph below). In a third situation, a writing is needed to produce some specific legal result beyond that of merely evidencing the contract. This is for example the case of the air cargo carriage contract under the 1929 Warsaw Convention.<sup>10</sup> Under this text, the issuance of an air waybill is not required as a condition for entering into a contract for the carriage of goods, but it is required to give the carrier the benefit of the provisions of the Convention providing for limitation of liability of the carrier. That rule will be changed when the 1975 Montreal Additional Protocol No. 4 enters into force. Under article III of the protocol, issuance of an air waybill will no longer be required for the carrier to benefit from the provisions limiting its liability.

12. Among the reasons for the requirement of a writing are a desire to reduce disputes by ensuring that there would be tangible evidence of the existence and contents of the contract; to help the parties be aware of the consequences of their entering into a contract; to permit third party reliance on the document; and to facilitate subsequent audit for accounting, tax or regulatory purposes.

13. What constitutes a "writing" is itself a matter of debate. The word has been defined in some countries, though normally by reference to the mode of imposition on the medium rather than by reference to the nature of the medium itself. For example, under the Interpretation Act 1978 in the United Kingdom,<sup>11</sup> "writing" includes typing, printing, lithography, photography and other modes of representing or reproducing words in a visible form, whilst section 1-201(46) of the Uniform Commercial Code in the United States provides that "written" or "writing" includes printing, typewriting or any other intentional reduction to tangible form. It is probably the case that whenever a statute uses the word "writing" without a definition, the legislator originally expected the writing to be on a traditional piece of paper or some other physical medium permitting the words to be read directly by humans.

14. The definition of a writing has often been extended to include a telegram or telex, as in article 13 of the United Nations Convention on Contracts for the International Sale of Goods. In article 7(2) of the UNCITRAL Model Law on International Commercial Arbitration, the definition of a writing has been further extended to encompass "telex, telegrams, or other means of telecommunication which provide a record of the agreement". Article 4(3) of the draft Convention on the Liability of Operators of Transport Terminals in International Trade provides that "the document...may be issued in any form which preserves a record of the information contained therein".

<sup>9</sup>The Convention for the Unification of Certain Rules Relating to International Carriage by Air, Warsaw, 12 October 1929, articles 5 to 9.

<sup>11</sup>Interpretation Act 1978, Schedule 1.

<sup>9</sup>See A/CN.9/265, Annex, question 11.

A similar idea is expressed in the definition of "notice in writing" in article 1(4)(b) of the 1988 UNIDROIT Convention on International Factoring, in which a writing "includes, but is not limited to, telegram, telex and any other telecommunication capable of being reproduced in tangible form".

### B. A comparative survey of European legislation: the TEDIS study

15. In 1988, the Commission of the European Communities began to implement the TEDIS (Trade Electronic Data Interchange Systems) programme,<sup>12</sup> which has as one of its purposes the development of an appropriate legal framework for the increased use of EDI in the twelve member States of the European Communities.<sup>13</sup> One of the first activities in the legal programme of TEDIS was to conduct a general study of legal obstacles to the increasing use of EDI in the twelve member States of the European Communities, as had been recommended in the 1985 UNCITRAL resolution. The results of this study of national legislation were published in French in 1989 and an English language version is expected to be published soon.<sup>14</sup> A similar analysis is to be carried out in the near future concerning the national laws of the member States of the European Free Trade Association, which now participate in the TEDIS programme. The complete study is expected to be released before the end of 1990. In addition, the Commission of the European Communities has contracted for "the production of a report analysing the impact of EDI on contract formation and formulating proposals for the adaptation or the reform of the current legal situation."<sup>15</sup>

16. The findings of the TEDIS study, as well as the documents of a TEDIS-EDI Legal Workshop held in June 1989,<sup>16</sup> provide a valuable indication of what might be expected to exist in the legislation of States not covered in the study since the twelve member States of the European Communities represent several major legal families. While the specific problems may differ from one State to the next, and there may be certain problems in legal systems outside Europe that will not appear in the various TEDIS reports, those reports constitute a good indication of the legal issues that may arise as the use of EDI becomes more general. In particular, they give an indication of issues that would have to be taken into account in any regional or world-wide unification process.

17. One of the findings of the study<sup>17</sup> was that, in the European Communities, no country had as yet fully adapted its legislation to meet the specific needs and problems related to the development of EDI. According to

<sup>12</sup>Official Journal of the European Communities, L 285, 8 October 1987.

<sup>13</sup>See A/CN.9/292, paras. 24 and 25.

<sup>14</sup>TEDIS - Situation juridique des Etats membres au regard du transfert électronique de données, (Brussels, Commission of the European Communities, 1989).

<sup>15</sup>Official Journal of the European Communities, C 230, 7 September 1989.

<sup>16</sup>The TEDIS-EDI Legal Workshop, (Brussels, Commission of the European Communities, 1989).

<sup>17</sup>TEDIS — Situation juridique . . . (see note 14 *supra*), pp. 251-252.

the study, the most directly relevant legislation was an Italian statute that dealt with the organization of electronic mail as a public service and determined under what conditions documents transmitted electronically through such service could be granted a degree of legal value. Other legislation that was considered in the study dealt only indirectly with EDI. The issues considered in those national laws were:

- the conditions under which computer records can be admitted as evidence in court, with the same evidentiary value as that of the original documents they purport to reproduce;

- the extent to which accounting records can be held electronically and the conditions under which one could be allowed to store the documents or information on which such accounting was based exclusively on computer;

- the possibility of allowing tax or customs declarations to be submitted by electronic means.

18. The TEDIS study makes it clear that, although efforts have been made at the national level to solve some of the problems arising from the use of EDI, and more specifically those related to the legal value of computer records, many other problems, typically those of contract making by electronic means, remain subject to traditional rules. Those rules would need to be interpreted, developed and updated by case law or national administrative practice in order to fit with an EDI environment. The forthcoming TEDIS report on contract formation is expected to give a clearer indication of the extent to which the traditional rules may remain appropriate in an EDI environment.

19. The current TEDIS study<sup>18</sup> identifies as the principal legal impediments to the increasing use of EDI the requirement that documents be drawn, transmitted or stored on signed papers and the legal requirements on evidence. This is essentially the conclusion that was reached as regards computer records in the 1985 report.

#### 1. The requirement to draw, deliver, send or store documents on signed papers

20. The reasons for the requirement to draw, deliver, send or store documents on signed papers are varied and the contents of the requirement itself are subject to considerable variation from one legal system to another.

##### (a) Application to contracts

21. According to the principle of party autonomy, which exists in most legal systems, parties may conclude contracts by any means they agree upon. If the form, or absence of form, chosen for the formation of the contract provides no physical evidence of the common will of the parties to enter into a contract, the enforceability of the contract may be affected but generally not its validity.

22. As an exception to the above stated principle, the TEDIS study notes that most legal systems distinguish

<sup>18</sup>*Ibid.*, pp. 254 ff.

between various categories of contracts, some of which could not be validly concluded through electronic means while others, although they could be concluded, would experience specific difficulties in an EDI context.

23. As an example of such exceptions, under many national laws, there exists a category of contracts whose validity depends upon the fulfilment of some formality. Although this category of contracts is more abundant in civil law countries, it is not unknown to the common law systems. It is often the case that the required formality is the conclusion of the contract in written form. Certain contracts, such as the transfer or mortgage of real estate, or some long-term contracts for the lease of real estate, may be subject to additional formalities such as the existence of a notarized writing. In addition, in certain cases, the contracts may have to be registered with a public authority. For some other contracts, the only required formality consists of the written form of the contract, without any additional statutory specification as regards the form of the writing. In several civil law countries, this category encompasses a variety of contracts including, amongst others, the transfer of registered ships, the mortgage of ships or aircrafts and all contracts concluded for the use of ships. In the current situation where little has been done by most national authorities to allow for such required formalities to be completed by electronic means, those solemnized contracts remain outside the scope of EDI.

24. In those legal systems where the requirement of a writing exists, it varies considerably from one national law to another. There are legal acts that are required to be in writing under the law of one or more of the twelve States but not under the law of other member States. Where such a requirement exists, the same sort of writing is not necessarily required by all national laws; for the formation of one single type of contract, a simple signed writing may be required for evidentiary purposes in one State, whereas a notarized writing would be required for validity purposes in another.

25. In general, the TEDIS study<sup>19</sup> indicates that a writing is required for validity purposes:

— whenever it is necessary to render a transaction opposable to third parties. The formality in this case is generally that the writing should then be authenticated or registered with some public authority;

— whenever a right is incorporated in a document of title or negotiable instrument and the transfer of the right is operated by the transfer of the document of title or negotiable instrument;

— whenever the legislation is intended to protect one party to a contract who might otherwise be in an inferior position *vis-à-vis* the other contracting party. This is for example the case of certain contracts for the sale of goods to private consumers.<sup>20</sup>

<sup>19</sup>*Ibid.*, pp. 256-257.

<sup>20</sup>For example, under some statutes adopted for the protection of private consumers, deferred payment sales and sales contracts concluded at the domicile of the buyer must be made in writing. There generally exists no such requirement for contracts concluded within automatic teller systems or point-of-sale systems.

#### (b) *Extent to which it is an obstacle to EDI*

26. The mandatory requirement of a writing as traditionally understood as a condition to the validity of a legal act is, in its pure form, a major theoretical obstacle to the increasing use of EDI: as long as the requirement is maintained, EDI as a means of concluding the contract would be excluded.

27. The study of legal systems in the twelve member States of the EEC shows that, in fact, national rules on the exchange of goods and services are not very formalistic. In practice, the need to create paper documents, or to sign or manually authenticate paper documents for purposes of contract formation, is more to be considered as an exception than as the normal requirement between trade partners who would be directly interested in developing EDI relationships. This is partly due to the rules on evidence in commercial litigation as opposed to the rules on evidence in non-commercial litigation (see paragraphs 32 to 34 below).

28. Except for the special needs of evidence and the record keeping requirements for tax or regulatory purposes (see paragraphs 38 to 41 below), no formal condition is required in EEC member States for concluding or drawing most commercial contracts, or for sending purchase orders, general conditions of sale, invoices or the like.

## 2. *Evidence*

29. As regards the law of evidence, the TEDIS study broadly distinguishes between the rules applied to litigation in civil law countries and to litigation in common law countries, and the rules governing the retention of business records for tax and regulatory purposes.

#### (a) *Evidence in civil law countries*

30. The TEDIS study<sup>21</sup> notes that the development of EDI meets legal obstacles in civil law countries due to the uncertain value of a copy, since all computer records and computer printouts are copies of an original, whether the original is a paper document or an electronic message.

31. In those cases where a signed original is required in civil law countries, the requirement is made with a view to constituting evidence acceptable by the courts in case of litigation, and also evidence for accounting, tax or other regulatory purposes. In both cases, the written evidence must be stored and kept available during the entire period of time when litigation can be initiated, or until such time the public authorities are no longer entitled to contest the facts in question.

32. In those countries where a general rule of civil law (as distinguished from commercial law) is that economic transactions can be proven in litigation only by a writing, there are many exceptions. For example, under the law of those countries, a writing is generally not required for transactions of a small amount. It is also the fact that, where a written document that is not the contract itself

<sup>21</sup>TEDIS — *Situation juridique* ... (see note 14 *supra*), p. 260.

contains some material in relation with the substance of the contract, it can generally be admitted as evidence. Yet another exception may exist where it is impossible for a party to obtain written evidence of the contract.<sup>22</sup> It must be pointed out that the general requirement of a writing is considered as an evidentiary requirement of civil law and not of commercial law, where evidence of contracts can be presented to a court in any form.

33. The consequence is that the requirement of a writing does not affect EDI as used for most trading contracts. Since the determination of which rule on evidence applies depends upon the status of the defendant, the rule of civil law applies when a party who is not a merchant is the defendant and the rule of commercial law applies when the defendant is a merchant. In this context, the characterization of the plaintiff as a merchant or as a non-merchant is irrelevant.

34. Even when the civil law rule applies, in many countries the requirement of a written evidence is considered not to be mandatory. It is therefore generally possible for the parties to agree beforehand that contracts they enter into will be evidenced by means other than a writing.

35. The TEDIS study concludes that:

“— In some member States which, as did Luxembourg, passed specific legislation expressly allowing computer records to be produced in litigation, and giving to such records the same evidentiary value as that of the documents they purport to reproduce, the law of evidence is no longer an obstacle to the development of EDI.

“— In other member States where no specific legislation on electronic documents has been passed and where the requirement of a writing for evidentiary purposes is not a mandatory rule, private EDI networks have developed and should be able to continue to develop in the future, provided that agreements, which could take the form of general conditions applying to all individual transactions concluded within the network, contained an appropriate provision that the record of the transactions would be admitted as evidence.

“— An analysis of the law of evidence in ‘continental’ legal systems shows that the rule of the signed writing required as evidence of a legal act has very large exceptions which make it rarely applicable to EDI economic transactions. The requirement of a writing for evidentiary purposes in civil law countries would lead to difficulties only in the fields of credit (particularly consumer credit) and insurance, since an insurance contract which has not been agreed upon in writing can generally not be asserted against the insurance company.”<sup>23</sup>

(b) *Evidence in common law countries*

36. The TEDIS study<sup>24</sup> states that in the common law, the rules of evidence that have a direct impact on EDI are the “hearsay evidence rule” and the “best evidence rule”.

<sup>22</sup>For an example of such a rule and some exceptions, see articles 1341, 1347 and 1348 of the French Civil Code.

<sup>23</sup>TEDIS — *Situation juridique* . . . (see note 14 *supra*), p. 263. The translation of the original French text was made by the Secretariat.

<sup>24</sup>*Ibid.*, pp. 265-266.

According to the hearsay evidence rule, subject to certain exceptions, a document is not admissible as evidence for the purpose of proving the truth of the matters stated in the document. According to the best evidence rule, only the original documents should be presented as evidence.<sup>25</sup> As in civil law countries, there is general agreement that a computer printout is not an original. Both of those rules in their pure form would be serious obstacles to the increasing use of EDI. To overcome them in the United Kingdom, section 5 of the 1968 Civil Evidence Act expressly allowed the use of computer printouts as evidence.

37. The general conclusion of the TEDIS study on evidence in litigation was that, while there were no major obstacles to the development of EDI in civil law countries, and therefore no need for fundamental changes of the rules, the common law countries showed theoretical difficulties which made it necessary to adopt statutory law to meet the needs of EDI.

(c) *Evidence in accounting and tax law*

38. The conclusions of the TEDIS study<sup>26</sup> are very different as regards the requirement of a writing for accounting or tax purposes.

39. In some member States, such as Luxembourg, legislation has been revised so as to admit accounting records to be kept exclusively on computers and to admit computer storage of documents or data on which accounting records or a tax declaration is based. In some others, such as Belgium, difficulties arising from the requirement of a writing have been solved by public authorities through codified administrative tolerance. In some other member States, such as Italy, legislation authorizes individual agreements to be concluded with the public authorities permitting one or both of those two uses of the computer.

40. In some States where no such solutions have been implemented, the obligation to keep written accounting records or the obligation to maintain supporting data exclusively on paper constitutes an obstacle to the development of contract formation or implementation through EDI. For example, in Danish law, no general rule determines the form of an invoice. Therefore, an invoice can be validly transmitted by electronic means. However, the data that is supposed to be evidenced by the invoice can be taken into account, according to the rules on accounting and tax, only if a paper original or a certified copy of the paper original is kept. Under French law, a similar practical obligation to deliver written invoices results from price control regulation.

41. In most legal systems where documents can be kept on microfilm or can be computer recorded, the paper originals must generally be kept for a certain period of time and the computer documents must at all times be available and capable of being reproduced in human readable form through a printing device. The TEDIS study does not make it clear whether those legal systems distinguish between a copy of the entire document (including, for instance, manuscript signatures), obtained by recording

<sup>25</sup>See A/CN.9/265, paras. 27 to 48.

<sup>26</sup>TEDIS — *Situation juridique* . . . (see note 14 *supra*), pp. 263-266.

it in digital form and a simple reproduction of the contents of the original document obtained by re-keying the text into a computer.

### C. The report of the American Bar Association<sup>27</sup>

42. A study was initiated in 1987 by the Electronic Messaging Services Task Force under the auspices of the American Bar Association (ABA) to examine the effects of electronic commerce upon fundamental principles of contract law and related legal issues. A first report on "Electronic Messaging" was released in 1988<sup>28</sup> and the final Report on Electronic Commercial Practices, incorporating a Model Electronic Data Interchange Trading Partner Agreement and commentary, was published in 1990. A presentation of the final report was made to the international EDI community at the thirty-first session of the Working Party on Facilitation of International Trade Procedures of the Economic Commission for Europe in March 1990.<sup>29</sup> This report, which concentrates on the legal issues related to the sales contract under the law of the United States of America, constitutes a valuable attempt to identify and solve, amongst others, the problems that may arise in a common law country which has maintained the traditional requirement of a writing contained in the Statute of Frauds. The original 1677 Statute of Frauds was passed in the United Kingdom with a view to reduce the frauds involved in contracts at a time when the law of evidence was undeveloped. Among other evidentiary rules, it required certain types of contract to be evidenced in prescribed written modes. This requirement in regard to a contract for the sale of goods is set out in section 2-201 of the Uniform Commercial Code as follows:

"A contract for the sale of goods for the price of \$500 or more is not enforceable unless there is some writing sufficient to indicate that a contract has been made between the parties and signed by the party against whom enforcement is sought."

43. The report also notes that the United States has ratified the United Nations Convention on Contracts for the International Sale of Goods and that, as a result, no writing is required for contracts of sale subject to that Convention.

44. The report notes that the definition of "writing" and of "signature" can be of particular importance (see paragraph 13 above). Potential difficulties can be overcome either by a mutual agreement that, in respect of future EDI communications constituting an offer or acceptance of a contract, the parties will not assert a defence based upon the Statute of Frauds, or by a special provision in their trade agreement that the parties agree to consider EDI communications as "written" and "signed" messages. However, one of the important findings of the report is that, even when EDI users enter into communication

agreements with one another, they seldom address the problems resulting from the Statute of Frauds. Since EDI is currently used mainly between trading partners with a long-term relationship, a failure to address the Statute of Frauds problems has apparently not led to serious difficulties or, at least, those difficulties have not resulted in litigation. However, such problems can be expected to arise when EDI is used more widely and in a more open environment.

45. The report notes that, although a number of exceptions to the application of the Statute of Frauds have been recognized by the Courts, no case law exists regarding EDI. After analysing commercial practices, the authors of the report conclude that:

"The issue is whether the records of EDI communications, which are increasingly relied upon by businesses themselves, are acceptable within the 'signed writing' concepts of the Uniform Commercial Code and related case law. Alternatively, in light of the repetitive nature of the use of EDI to complete commercial transactions and the mutual efforts of trading partners required to structure and maintain appropriate communication systems and security procedures, the issue may be whether either trading partner may be estopped from asserting the Statute of Frauds against the other to avoid the enforcement of any underlying contract for the sale of goods. Several members of the Task Force were reasonably confident the Statute of Frauds would not, under either analysis, preclude enforcement."<sup>30</sup>

46. On this point, the report concludes that there is a need for trading partners to adopt some form of a bilateral agreement governing their EDI relations and to make sure that this agreement addresses the Statute of Frauds issues.

47. It was pointed out in the ABA Report that:

"The failure of the Uniform Commercial Code to specifically accommodate the electronic communication of data has not been fatal to either the continued growth of electronic commercial practices or the continued vitality of the Code itself. ... Yet the existence of a less than ideal fit . . . has had an impact upon adoption of EDI in commercial use."<sup>31</sup>

This remark may be applied to most national legislation where legal issues may have to be reconsidered with a view to the accommodation of EDI.

## II. OTHER LEGAL ISSUES RELATED TO THE FORMATION OF CONTRACTS

### A. Acknowledgement of receipt of messages

48. A significant feature of EDI is that a prompt and reliable acknowledgement that a message has been received is possible for an insignificant cost. At some greater cost, resulting from more extensive computer processing, it is possible to verify that the message has

<sup>27</sup>The *Commercial Use of Electronic Data Interchange—A Report*, (Chicago, Illinois, American Bar Association, 1990). To be published in *The Business Lawyer*, vol. 44 (1990).

<sup>28</sup>*Electronic Messaging. A Report of the Ad Hoc Subcommittee on the Scope of the UCC*, (Chicago, Illinois, American Bar Association, 1988).

<sup>29</sup>See TRADE/WP.4/GE.1/79, paras. 37 and 38.

<sup>30</sup>The *commercial use of EDI . . .* (see note 27 *supra*), pp. 69-70.

<sup>31</sup>*Ibid.*, pp. 28-29.

been received intact without communication errors. At a still greater cost, encryption techniques are available that permit, in a single operation, the verification of both the non-alteration of the message and the certain identity of the sender (see paragraphs 55-56 below).

49. Several of the rules and model communication agreements recently developed include special provisions encouraging systematic use of "functional acknowledgements" and verification procedures. Acknowledgement of receipt merely confirms that the original message is in the possession of the receiving party and is not to be confused with any decision on the part of the receiving party as to agreement with the content of the message. Nevertheless, an acknowledgement of receipt serves to eliminate many of the problems that have long been debated when contracts have been concluded by distant parties.

### B. Authentication of messages

50. Although an authentication procedure required by law must be in the form prescribed, an authentication method required by the parties can consist of any mark or procedure they agree upon as sufficient to identify themselves to one another.

51. The 1985 UNCITRAL recommendation (see paragraph 2 above) also identified the legal requirements of a handwritten signature or other paper-based method of authentication as an obstacle to EDI. In line with this recommendation and a 1979 recommendation by the ECE Working Party on Facilitation of International Trade Procedures, which had expressed a similar concern,<sup>32</sup> efforts are being made by the TEDIS group within the EEC to encourage the removal of mandatory requirements for handwritten signatures in national legislation. Similar efforts are being made in a number of other countries.

52. In spite of such efforts, the most common form of authentication required by national laws remains a signature, which is usually understood to mean the manual writing by an individual of his name or initials. Legal systems increasingly permit the required signatures of some or all documents to be made by stamps, symbol, facsimile, perforation or by other mechanical or electronic means. This trend is most evident in the law governing transport of goods, where all the principal multilateral conventions that require a signature on the transport document permit that signature to be made in some way other than by manual signature.<sup>33</sup>

53. However, it can be recalled that, even though manual signature, or its physical reproduction by mechanical or other means, is familiar and inexpensive and serves well for transaction documents passing between known parties, it is far from being the most efficient or the most secure method of authentication.<sup>34</sup> A manual signature can be forged and a stamp can be applied by anyone into

whose possession it comes. The person relying on the documents often has neither the name of the persons authorized to sign nor specimen signatures available for comparison. This is particularly true of many documents relied upon in foreign countries in international trade transactions. Even where a specimen of the authorized signature is available for comparison, only an expert may be able to detect a careful forgery. Where large number of documents are processed, signatures are sometimes not even compared except for the most important transactions.

54. Some new techniques have been developed to authenticate electronically transmitted documents. As regards identification of the transmitting machines, telex and computer-to-computer telecommunications often employ call back procedures and test keys to verify the source of the message. Where cryptography is not forbidden by law, an algorithm can be used for the coding of the text, the reading of which requires application of the corresponding decoding key. For example, such a system is used by the the Society for Worldwide Interbank Financial Telecommunications S.A. (SWIFT), which recently adopted a new authentication algorithm. The secret key is intended to be long enough and the algorithm is said to be "sufficiently resource-hungry" to discourage any one from attempting all the possibilities.<sup>35</sup> Techniques combining several keys can also be used as a means of identifying the operator of the sending machine. A text using modern cryptography could not be deciphered by an unauthorized person in a commercially significant period of time.

55. More generally, as regards identification of persons in an EDI context, verification procedures can be based upon one or more of three parameters: what the operator knows (passwords, secret codes), what the operator holds (microcircuit cards) or what the operator is (biometrics). Of the three, biometrics (i.e. the physical characteristics of the operator) is the most exact. Six biometric technologies are currently available: retina scans which record the eye signature of an individual and store it in a microprocessor; thumbprint or fingerprint identification systems; hand geometry systems which measure, record and compare finger length, skin translucency, hand thickness or palm shape; voice verification devices which record voice patterns and inflections; signature verification devices which trace either the static or dynamic characteristics of a person's signature; keystroke dynamics which identify individuals by their typing patterns and rhythms. All of these biometric products compare the stored templates with fresh patterns or scans to allow or deny access to the secured mechanism.<sup>36</sup>

56. Electronic forms of authentication using computers offer one major advantage over visual comparison of manual signatures. The procedure is so rapid and relatively inexpensive, except for biometric techniques, which are currently too expensive for general commercial use,

<sup>32</sup>See TRADE/WP.4/INF.63; TD/B/FAL/INF.63; also quoted in A/CN.9/265, note 28.

<sup>33</sup>A/CN.9/225, para. 47.

<sup>34</sup>See A/CN.9/265, paras. 49 to 58.

<sup>35</sup>S.W.I.F.T. Newsletter, April-May 1990, p. 12.

<sup>36</sup>Stephen Castell, "The legal admissibility of computer generated evidence towards 'legally reliable' information and communications technology (IACIT)", *The Computer Law and Security Report*, vol. 5, issue 2, (July-August 1989), p. 6 ff.

that every authentication can be verified as a routine matter. There is no need to restrict verification to the most important transactions.

57. An individual document sent by telecommunications can be confirmed by a subsequent signed writing, as has been a customary practice in regard to telegrams and telex. Although in many cases this could be seen as defeating the purpose of EDI, it has been reported that such a practice is common among EDI users.<sup>37</sup> However, two parties who anticipate communicating frequently by EDI may agree in writing beforehand on the form of the communications and the means to be used to authenticate the documents. It could be expected that such an agreement would be sufficient to allow the use of the record of the EDI message as evidence. A similar agreement may be also required by an administrative organ of the State before it will accept documents in electronic form, whether by telecommunication or by manual transmission of a computer memory device such as a diskette or magnetic tape.

58. It is clear that the fundamental issue at the heart of all aspects of the legal admissibility of digitally transmitted and processed data and information is that of the legal reliability of information and communication technology.

“ ‘Legal reliability’ actually implies ‘demonstrably and unarguably high standards of authorization, operational and access control and management’ of use of information and communication technology systems. ‘Authorization’ further implies ‘accurate, precise and dependable identification, verification and authentication technologies and techniques which are, or may become, as legally acceptable as the conventional trust and comfort of a manual signature written in ink on paper’ ”<sup>38</sup>.

59. However, the extent to which such methods would receive legal recognition in States where signature is required by law for a particular document remains a matter of great uncertainty. Where the law has not been interpreted by the courts or other reliable source so as to consider an electronic form of authentication as a “signature”, it is likely that this uncertainty will be overcome only by legislation. A question for consideration is how far such legislation, when specifically permitting or requiring authentication to be made by EDI, should require evidence of conformity with an applicable EDI protocol, at least as a condition of attracting a presumption of authenticity, the onus of proof being shifted to the party asserting the authenticity of the message in cases where the requirements of the protocol are not satisfied.

### C. Consent, offer and acceptance

60. The expression of will through distant machines has long been admitted in case law in view of the fact that those machines were closely controlled by human beings.

It is to be noted that the quality of the communication that can be offered by EDI technology is such that errors in the transmission of messages are likely to be less frequent than with more traditional techniques. Therefore, the risk of a discrepancy between the message as it is sent and the message as it is received is probably lessened by the adoption of EDI. As regards quality of communication between computers, the use of a common and structured application protocol such as EDIFACT (Electronic Data Interchange for Administration, Commerce and Transport) is essential for the increasing use of international EDI (see paragraph 79 below).

61. In contrast with various traditional communication techniques, including post, telephone and telex, EDI creates new opportunities for the automation of the decision-making process. For example, a purchaser's computer may be programmed to send purchase orders under certain circumstances, and the supplier's computer may be programmed to act upon the orders it receives, both without human intervention. This situation may increase the possibility that, due to the lack of a direct control by the owners of the machines, a message will be sent, and a contract will be formed, that does not reflect the actual intent of one or more parties at the time when the contract is formed. For the same reason, this situation undoubtedly increases the possibility that, where a message is generated that does not reflect the sender's intent, the error will remain unperceived both by the sender and by the receiver until the mistaken contract has been acted upon. The consequences of such an error in the generation of a message might therefore be greater with EDI than with traditional means of communication.

62. As a general rule, one cannot be bound by a contract to which one has not given one's consent. However, in many legal systems, the owner of a terminal, in certain cases, might be bound by contracts to which he had not personally given his consent,<sup>39</sup> such as in the examples given in the previous paragraph. In the absence of contractual provisions dealing with that situation, the purchaser might be bound on several legal grounds including the risk he assumed in implementing an automatic purchase ordering system and, under some national laws, the apparent will that was expressed in the message.<sup>40</sup>

63. If the author of a contractual offer or acceptance contends that there is a discrepancy between his apparent will as reflected in the electronic transmission and his actual will, some legal systems provide for mechanisms that allow him to establish his actual will in the absence of a fault or of a negligence on his part. Legal rules on error, which to some extent would also apply in the case of fraud, exist in most legal systems, but national laws differ greatly as to whether or not the consequences of the error are to be borne by the person whose message has been altered (see paragraph 76 below).

<sup>39</sup>For a discussion of the issues of consent in contracts made by electronic means, see Ettore Giannantonio, *Trasferimenti Elettronici dei Fondi e Autonomia Privata*, (Milano, Giuffrè Editore, 1986).

<sup>40</sup>Bernard E. Amory, “EDI and the conclusion of contract”, *The TEDIS-EDI Legal Workshop*, (see note 16 *supra*).

<sup>37</sup>*The commercial use of EDI . . .* (see note 27 *supra*), p. 18.

<sup>38</sup>*The APPEAL Study* (appendix on evidence admissible in law), (London, Central Computer and Telecommunication Agency, British Treasury, 1988), quoted by S. Castell, (see note 36 *supra*), pp. 7-8.



64. The variety and complexity of national laws as regards the expression and validity of consent in the contract-making process, as well as the revocability of an offer, illustrate the need for parties to conclude a communication agreement dealing with that issue prior to the establishment of an EDI relationship, as is sometimes done for "just-in-time" supply contracts.

#### D. General conditions<sup>41</sup>

65. As regards general sale conditions, the major problem is to know to what extent they can be asserted against the other contracting party. In many countries, the courts will consider whether it can reasonably be inferred from the context that the party against whom general conditions are asserted has had an opportunity to be informed of their contents or whether it can be assumed that the party has expressly or implicitly agreed not to oppose all or part of their application.

66. Some legal systems permit that,

"where trading partners have an established history of dealing on known standard terms, the terms may be incorporated into individual transactions by custom or usage, without the exchange of a document on each individual occasion. However, the longer two trade partners deal without actually exchanging formal terms of dealing, the weaker the foundation for that implication of customary usage may become".<sup>42</sup>

In any case, such usage would not exist in the case of a new trading relationship between partners who do not have an "established history" of dealing with each other.

67. EDI is not equipped, or even intended, to transmit all the legal terms of the general conditions that are printed on the back of purchase orders, acknowledgements and other paper documents used by trading partners. A solution to that difficulty is to incorporate the standard terms in a communication agreement between the trading partners. It has been remarked that:

"one of the most salutary effects that the introduction of EDI could have on business practices would be to require the formulation of mutually acceptable (and therefore more reliable) terms of dealing between important trading partners through the conscious negotiation of new master agreements".<sup>43</sup>

68. One suggestion that has been made where the parties cannot settle on common standard terms is that they attach their respective paper forms to the communication agreement. It is possible for the agreement to provide

"that each of buyer's purchase order transaction sets will be deemed to incorporate the terms on the back of the buyer's form and that each of seller's purchase order

acknowledgements will be deemed to incorporate seller's terms."<sup>44</sup>

Thus, the conflicting standard terms would effectively be exchanged through EDI. While this technique would permit the parties to reach an agreement on the main issues, it would leave the same uncertainty as to the applicable terms of the general conditions as if they had exchanged the traditional paper forms.

#### E. Time and place of formation of the contract

69. Parties to a contract have a practical interest in knowing, with some certainty, where and when the contract is formed. When the contract is formed, the parties become bound by the legal obligations they have agreed upon and the contract may start producing effects. In different legal systems, the time when the contract is formed may determine such issues as the moment when the offeror is no longer entitled to withdraw his offer and the offeree his acceptance; whether legislation that has come into force during the negotiations is applicable; the time of transfer of the title and the passage of the risk of loss or damage in the case of the sale of an identified good; the price, where it is to be determined by market price at the time of the formation of the contract. In some countries, the place where the contract is formed may also be relevant for determining the applicable customary practices; the competent court in case of litigation; and the applicable law in private international law.<sup>45</sup>

70. When dealing with the topic of contract formation, most systems distinguish between two situations: in the first one, the parties are in each other's presence and are able to communicate instantaneously or without any significant lapse of time; in the second one, the parties are not in each other's presence and the means of communication utilized to transmit offers, acceptances, modifications, revocations and other messages result in a delay between the dispatch and receipt of those communications.

71. Since a contract requires mutual assent of the parties, many legal systems agree that a contract is formed when both parties are aware of each other's consent. However, when parties communicate through a non-instantaneous or delayed media, such as mailed writings, the party who receives a message cannot verify that the sender's will at the time the message was sent remains the same at the time the message is received. Neither can either party verify in a timely fashion that receipt of the message has occurred and that the message is received without errors.

72. Two main theories, each with a variant, are used to overcome this problem to which no fully satisfactory solution is known. The receipt rule—with its variant: the information rule—states that the contract is formed when the offeror receives notice, or is informed, of the offeree's

<sup>41</sup>Bradley Crawford, "Strategic legal planning for EDI", *Canadian Business Law Journal*, vol. 16, December 1989, pp. 66 ff.

<sup>42</sup>*Ibid.*, p. 69.

<sup>43</sup>*Ibid.*, p. 70.

<sup>44</sup>See Benjamin Wright, *EDI and American Law - A Practical Guide*, (Alexandria, Virginia, TDCC: The Electronic Data Interchange Association, 1989), p. 30.

<sup>45</sup>Bernard E. Amory, "EDI and the conclusion of contract", *The TEDIS-EDI Legal Workshop*, (see note 16 *supra*).

consent. The declaration rule—with its variant: the dispatch rule—states that the contract is formed when the offeree declares or sends his acceptance of the offer to the offeror. In the case of written mail, many legal systems have adopted some form of the dispatch rule.<sup>46</sup> It may also be recalled that articles 18 and 23 of the United Nations Convention on Contracts for the International Sale of Goods state that the contract is formed at the moment the indication of assent reaches the offeror.

73. It is generally admitted that, under normal circumstances, a telephone communication is instantaneous, faithful and secure enough for a contract concluded by telephone to be treated as though it had been made in both parties' presence. Indeed, all other communication systems can also be classified by reference to the same three criteria: the degree of instantaneousness, the quality of the dialogue and the security of the communication.<sup>47</sup>

74. Modern means of communication are expressly addressed by some legal systems, and considered according to their degree of instantaneousness. For example, section 64 of the American "Restatement on Contracts (second)" states that

"telephone or other medium of substantially instantaneous two-way communication is governed by the principles applicable to acceptances where the parties are in the presence of each other".

In other systems, case law considers the particular problem of contract formed by telex. It has been stated that, telex transmission being instantaneous, the expedition rule should not apply to such contracts.<sup>48</sup> But it has also been suggested that, where communication by telex is not instantaneous (as, for example, where the message is sent out of office hours or at night, or by a third party's telex machine), the time and place of the formation of a contract so made by telex could be resolved only by reference to the intention of the parties, by sound business practice and in some cases by judgment where the risk should lie, and not by applying a universal rule.<sup>49</sup>

<sup>46</sup>In France, see *Cour de Cassation*, Req. 21 March 1932 (Recueil Sirey, 1932.1.278); Com. 7 January 1981 (Bull. civ. IV. II).

In the United Kingdom, where the normal rule is that an offer is accepted by the communication of the acceptance to the offeror, the Postal administration is considered as the agent of the offeror for the purpose of communicating the acceptance. See *Entores, Ltd. v. Miles Far East Corp.* (1955), All England Law Reports, p. 493.

In the USA, section 63 of the "Restatement on Contracts (second)" states that "Unless the offer provides otherwise, an acceptance made in a manner and by a medium invited by an offer is operative and completes the manifestation of mutual assent as soon as put out of the offeree's possession, without regard to whether it ever reaches the offeror; ...".

<sup>47</sup>See Bernard E. Amory and Marc Schauss, *E.D.I. as a way to perform and conclude contracts*, (paper presented to the COMPAT 88 conference on computer aided trade, The Hague, 1988) and "Formación de contratos: comunicación de la oferta y de la aceptación al oferente", *La validez de los contratos internacionales negociados por medios electrónicos*, (Madrid, Centro de estudios comerciales, Cámara de comercio e industria de Madrid, 1988).

<sup>48</sup>*Entores, Ltd. v. Miles Far East Corp.* (see note 46 *supra*), and *Brinkibon Ltd. v. Stahag Stahl- und Stahlwarenhandels-gesellschaft mbH* (1982), All England Law Reports, p. 293.

<sup>49</sup>Statement by Lord Wilberforce in *Brinkibon* (note 48 *supra*), also quoted by S. Harvey and J. Newman in "Contracts by electronic mail: some issues explored", *The Computer Law and Security Report*, vol. 3, issue 6, (March-April 1988), p. 2.

75. The question of the time and location of the formation of an EDI contract is identified in the TEDIS study as the one which receives the widest variety of solutions within national legislations in the EEC. The same question is addressed by the ABA report and may be regarded as one important issue to be settled in a communication agreement.

#### F. Risk of failure of communication

76. A question that is not directly related to the formation of contracts but that needs to be addressed within the contractual framework of an EDI relationship is the determination of which party is to bear the risk of a failure in communication of an offer, acceptance or other form of communication intended to have a legal effect, such as an instruction to release goods to a third party. The question of liability for failures in communication should also be considered in respect of the relations between the communicating parties and those providing the communication network.

### III. COMMUNICATION RULES AND AGREEMENTS

77. With paper, most fundamental issues on how to communicate have been understood for a long time, even though they have not always been solved the same way in all legal systems. With telex and telegrams, there has been no major difficulty in adapting the solutions that had been developed for paper communication, although the solutions vary.

78. EDI is sufficiently different from other forms of communication that a certain number of questions relating to the nature of the communication itself should be considered by parties intending to communicate with EDI. Some are generic questions which include, amongst others, agreement on common message standards. Other communication questions are specific to the nature of the intended contract.

79. The need for common or compatible message standards is easily met within a closed-user group where parties adhere to a common organization. An example of such a closed-user group is the SWIFT system for funds transfers between banks. The SWIFT rules specify the standard structured messages that are to be used, as well as such matters as when terminals are to be open to receive messages. However, the need for common standards is not so easily met when the communicating parties do not belong to such a closed-user group. In order to provide for such common standards, the Working Party on Facilitation of International Trade of the Economic Commission for Europe has been developing and will continue to develop the United Nations rules for Electronic Data Interchange for Administration, Commerce and Transport (UN/EDIFACT), which are defined as follows:

"They comprise a set of internationally agreed standards, directories and guidelines for the electronic interchange of structured data, and in particular that related

to trade in goods and services, between independent computerized information systems.

"Recommended within the framework of the United Nations, the rules are approved and published by the UN/ECE in the United Nations Trade Data Interchange Directory (UNTDID) and are maintained under agreed procedures. UNTDID includes:

- EDIFACT syntax rules (ISO 9735);
- Message design guidelines;
- Syntax implementation guidelines;
- EDIFACT Data Elements Directory, *EDED* (a subset of UNTDED);
- EDIFACT Code List, *EDCL*;
- EDIFACT composite data elements Directory, *EDCD*;
- EDIFACT standard segments Directory, *EDSD*;
- EDIFACT UNSMs Directory, *EDMD*;
- Uniform Rules of Conduct for the Interchange of Trade Data by Teletransmission (UNCID);
- Explanatory material, as appropriate."<sup>50</sup>

80. Both the TEDIS study and the ABA report come to the conclusion that, when EDI is used outside the ambit of closed-user groups, it is desirable to have some form of a framework communication agreement in which the parties agree on the manner in which they will communicate with EDI. Indeed, many efforts that have been or are being made in the legal field for the promotion of EDI involve the production of such communication agreements.

81. The existence of a communication agreement implies a pre-existing relationship between the communicating parties. This is the normal business situation where EDI is most likely to be used at the present time. Nevertheless, it indicates a limitation on the use of such agreements in a truly open environment.

#### A. The UNCID Rules

82. The first effort accomplished by the international EDI community to harmonize and unify EDI practices resulted in the adoption of the Uniform Rules of Conduct for Interchange of Trade Data by Teletransmission (UNCID) by the International Chamber of Commerce (ICC) in 1987 (ICC Publication No. 452, 1988). UNCID was prepared by a special joint committee of the ICC in which the United Nations Economic Commission for Europe (ECE), the Customs Co-operation Council (CCC), the UNCTAD Special Programme on Trade Facilitation (FALPRO), the Organization for Economic Co-operation and Development (OECD), the International Organization for Standardization (ISO), the Commission of the EEC, the European Insurance Committee, the Organization for Data Exchange via Teletransmission in Europe (ODETTE) and the Secretariat of UNCITRAL were represented.

83. Although the first draft of UNCID was based on the idea of creating a model communication agreement, it was

found that, due to the differing requirements of various user groups, the creation of a model communication agreement was an impracticable objective at such an early stage of development of EDI techniques. It was therefore decided to create a small set of non-mandatory rules on which EDI users and suppliers of network services would be able to base their communication agreements. UNCID was also incorporated into EDIFACT (see paragraph 79 above) as part of the United Nations Trade Data Interchange Directory. Although UNCID constitutes a limited achievement, it also represented a major step in the development of a legal framework for EDI, both because it furnished a basis for preparing individual communication agreements and because it served as a first effort that could later be used to reach a higher level of refinement.

84. UNCID has no implications for the substance of the underlying agreement. It aims "at facilitating the interchange of trade data effected by teletransmission, through the establishment of agreed rules of conduct between parties engaged in such transmission. Except as otherwise provided in these rules, they do not apply to the substance of trade data transfers" (article 1).

85. UNCID defines some elements of EDI terminology (article 2). It contains rules that call for the parties to an EDI agreement to provide, among other things, for care in transferring and receiving correct and complete messages (article 5); identification of the parties throughout the communication process (article 6); acknowledgement of receipt of a message, if requested (article 7); verification of the completeness of the received message (article 8); protection of some or all of the commercial information exchanged (article 9); maintenance of records of the transmissions and storage of data (article 10).

86. The introductory note to UNCID indicates that those rules can be considered only as preliminary to further agreements. It outlines

"certain elements that should be considered in addition to UNCID, when formulating an agreement:

1. There is always a risk that something may go wrong—who should carry that risk? Should each party carry its own or would it seem possible to link risk to insurance or to the network operator?
2. If damage is caused by a party failing to observe the rules, what should be the consequences? This is partly a question of limitation of liability. It also has a bearing on the situation of third parties.
3. Should the rules on risk and liability be covered by rules on insurance?
4. Should there be rules on timing, e.g. the time within which the receivers should process the data etc.?
5. Should there be rules on secrecy or other rules regarding the substance of the data exchanged?
6. Should there be rules of a professional nature—such as the banking rules contained in SWIFT?
7. Should there be rules on encryption or other security measures?

<sup>50</sup>TRADE/WP.4/171, para. 15.

## 8. Should there be rules on 'signature'?

It would also seem important to have rules on applicable law and dispute resolution."<sup>51</sup>

### B. Model communication agreements

87. Subsequent to the publication of UNCID, several model communication agreements have been prepared for general use. Particular mention might be made of the EDI Association of the United Kingdom (UK-EDIA) Standard Interchange Agreement, which was issued in March 1988, and the American Bar Association Trading Partners Model Agreement, which was introduced at the thirty-first session of the Working Party on Facilitation of International Trade Procedures of the Economic Commission for Europe in March 1990.<sup>52</sup> The two model agreements cover many of the same substantive questions, but each was drafted in the context of the domestic law of the country in question.

88. The TEDIS group within the Commission of the European Communities has begun the preparation of a European Model Interchange Agreement. While this effort takes into account the model agreements that have already been issued, changes are envisaged to take into account

the usages and legal requirements of the twelve member States of the European Communities.

89. The draft "Rules for the Electronic Transfer of Rights to Goods in Transit", prepared by the Comité Maritime International (CMI), (Paris, 16 January 1990), constitute a sectoral approach to EDI, with a view to their being applicable in a truly open environment. The draft Rules not only contain substantive rules that address the question of the replacement of the traditional bill of lading by an EDI message, but also contain provisions on communication issues. Those provisions are based upon the UNCID rules and they functionally constitute a communication agreement.

### CONCLUSION

90. The Commission may wish to request the Secretariat to complement this preliminary report with a further report to the next session of the Commission. The report to be submitted to the next session might indicate developments in other organizations during the year relevant to the legal issues arising in EDI. The report might also analyse existing and proposed model communication agreements with a view to recommending whether a model agreement should be available for world-wide use and, if so, whether the Commission should undertake its preparation.

<sup>51</sup>UNCID, pp. 10-11.

<sup>52</sup>TRADE/WP.4/R.652 and TRADE/WP.4/R.652/Corr.1.

## VI. INTERNATIONAL SALE OF GOODS

### Convention on the Limitation Period in the International Sale of Goods: note by the Secretariat (A/CN.9/334) [Original: English]

1. At its twenty-second session (1989), the Commission was informed that the Secretariat had established and had circulated by depositary notification a proposed text of the Convention on the Limitation Period in the International Sale of Goods (1974) as amended by the 1980 Protocol Amending the Convention on the Limitation Period in the International Sale of Goods. (A/44/17, paras. 262 and 263.) That text had been established in the five languages in which the United Nations Conference on the Prescription (Limitation) in the International Sale of Goods, which adopted the Convention, had been held, i.e., in Chinese, English, French, Russian and Spanish. Since Arabic was not one of the languages of the Conference, the Convention did not exist in that language; however, the Protocol, which was adopted by the United Nations Conference on Contracts for the International Sale of Goods, did exist in Arabic.

2. The Commission decided to request that an Arabic version of the Convention as amended by the Protocol be

established. To that end, it requested the Secretary-General to prepare an Arabic translation of the Convention as amended. The Commission decided that it would review the translation at its twenty-third session, at which time it would propose a text to the Secretary-General that might be circulated by depositary notification, giving all States the opportunity to comment on the proposed text before it was published as the definitive Arabic language version of the Convention as amended. (A/44/17, para. 264.)

3. The text of the requested translation into Arabic of the Convention as amended by the Protocol is annexed to the present note.<sup>a</sup>

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<sup>a</sup>The text in Arabic was reproduced in all language versions of this note. It became Annex II of the Report of the Commission, but was reproduced only in the Arabic language version of that report.

## VII. CO-ORDINATION OF WORK

### Current activities of international organizations related to the harmonization and unification of international trade law: report of the Secretary-General (A/CN.9/336) [Original: English]

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## INTRODUCTION

1. The General Assembly, in resolution 34/142 of 17 December 1979, requested the Secretary-General to place before the United Nations Commission on International Trade Law, at each of its sessions, a report on the legal activities of international organisations in the field of international trade law, together with recommendations as to the steps to be taken by the Commission to fulfil its mandate of co-ordinating the activities of other organizations in the field.

2. In response to that resolution, detailed reports on the current activities of other organizations related to the harmonization and unification of international trade law have been issued at regular intervals, the last one having been submitted at the twenty-second session in 1989 (A/CN.9/324).

3. This report is another in the series mentioned and has been prepared in order to update and supplement the report submitted at the twenty-second session of the Commission. It is based on information available to the Secretariat about the activities of international organizations covered up to 15 February 1990. Documents referred to in this report and further information may be sought directly from the organizations concerned. The Secretariat appreciates the assistance given to it by all those international organizations and others that sent information on their current activities related to the harmonization and unification of international trade law.

4. The activities of UNCITRAL related to the harmonization and unification of international trade law are referred to briefly in this report for the sake of completeness. The current work of UNCITRAL is summarized each year in the reports of the Commission's annual sessions. The reports and the background documents are subsequently reprinted in the *Yearbook of the United Nations Commission on International Trade Law*.

5. The work of the following organizations is described in the present report:

*(a) United Nations bodies and specialized agencies*

CTC:	Centre on Transnational Corporations; paragraphs 41, 45, 46, 47, 48, 49, 50, 51
ECE:	Economic Commission for Europe; paragraphs 12, 13
GATT:	General Agreement on Tariffs and Trade; paragraphs 6, 113
IBRD:	International Bank for Reconstruction and Development (World Bank); paragraph 37
IMO:	International Maritime Organization; paragraphs 82, 89, 92
UNCITRAL:	United Nations Commission on International Trade Law; paragraphs 7, 11, 70, 72, 73, 81, 90, 110
UNCTAD:	United Nations Conference on Trade and Development; paragraphs 14, 22, 23, 24,

25, 26, 27, 28, 29, 30, 33, 42, 43, 52, 53, 54, 55, 77, 78, 79, 80, 81, 82, 83, 84, 85, 86, 87, 88, 117, 118

UNDP:	United Nations Development Programme; paragraphs 29, 55
UNESCO:	United Nations Educational, Scientific and Cultural Organization; paragraphs 58, 59, 60
UNIDO:	United Nations Industrial Development Organization; paragraphs 31, 32, 34, 35, 56, 57
WIPO:	World Intellectual Property Organization; paragraphs 58, 61, 62, 63, 64, 65, 66, 67, 68

*(b) Other intergovernmental organizations*

AALCC:	Asian-African Legal Consultative Committee; paragraphs 39, 100, 101
CCC:	Customs Co-operation Council; paragraphs 114, 116
CMEA:	Council for Mutual Economic Assistance; paragraphs 8, 9, 10, 44, 102, 106
CE:	Council of Europe; paragraphs 120, 121
EEC:	European Economic Community; paragraph 25
HAGUE CONFERENCE:	Hague Conference on Private International Law; paragraphs 111, 112
OAS:	Organization of American States; paragraph 99
OTIF:	Intergovernmental Organization for International Carriage by Rail; paragraph 97
PTA:	Preferential Trade Area for Eastern and Southern African States; paragraphs 38, 41, 110
UNIDROIT:	International Institute for the Unification of Private Law; paragraphs 15, 19, 21, 69, 98, 119, 123

*(c) International non-governmental organizations*

CMI:	Comité Maritime International; paragraphs 82, 91, 93, 94, 95
FIATA:	International Federation of Freight Forwarders Associations; paragraph 88
FIDIC:	International Federation of Consulting Engineers; paragraph 36
ICC:	International Chamber of Commerce; paragraphs 16, 17, 18, 20, 40, 71, 74, 75, 76, 88, 103, 104, 105, 106, 115
ICCA:	International Council for Commercial Arbitration; paragraphs 107, 108
ICPE:	International Center for Public Enterprises in Developing Countries; paragraph 56
ILA:	International Law Association; paragraphs 46, 109, 122

## I. INTERNATIONAL COMMERCIAL CONTRACTS IN GENERAL

### A. Procurement

#### 1. GATT

6. At the General Agreement on Trade and Tariffs (GATT) negotiations are underway, in pursuance of Article IX:6(b) of the GATT Agreement on Government Procurement, aiming at broadening and improving the Agreement on the basis of mutual reciprocity. The possibilities of expanding the coverage of the Agreement to include service contracts are also being discussed in that connection. In the ongoing Uruguay Round of Trade Negotiations some participants have raised issues relating to the terms of accession to the Agreement.

#### 2. UNCITRAL

7. At its nineteenth session in 1986, the Commission decided to take up the topic of procurement and it entrusted the subject to the Working Group on the New International Economic Order. The Working Group held its eleventh session in New York from 5 to 16 February 1990 (A/CN.9/331). At that session the Working Group considered a draft model law on procurement (A/CN.9/WG.V/WP.24) and a commentary on the draft model law on procurement (A/CN.9/WG.V/WP.25) prepared by the Secretariat.

### B. CMEA: general conditions

8. In 1988 the CMEA Conference on Legal Questions completed the elaboration of a revised text of the General Conditions Governing Delivery of Goods (GCD) among organizations of CMEA member countries. The revised text consists of the 1968 GCD text with the incorporation of all amendments and additions introduced into it in 1975, 1979 and 1988. In particular, the GCD structure has been changed, the contractual procedure for specifying the quality requirements for goods has been revised, the rights of purchasers when goods of incorrect quality have been delivered are extended, the liability of the parties for violating their obligations has been increased, and the procedures for entering into, altering and terminating a contract have been revised, as well as the procedures for presenting and examining claims. In October 1988 the Executive Committee approved the revised GCD text and recommended States members of CMEA to apply it as from 1 July 1989. Also approved were the conditions for applying the GCD text to contracts for the delivery of goods between the organizations of the Socialist Republic of Vietnam and of other States members of CMEA. Previously, the conditions for the delivery of goods between Vietnam and other States members of CMEA were governed by bilateral documents. Work on the further improvement of the GCD text is being continued. In this connection, a comparative study of the provisions of the GCD text and of the United Nations Convention on Contracts for the International Sale of Goods is being prepared within CMEA's Standing Commission on Legal Matters.

9. CMEA's Standing Commission on Legal Matters is working on proposals designed to enhance the level of legal regulation of contractual relations between the economic organizations of States members of CMEA. In particular, the idea of a uniform regulation of the general provisions for contracts between the economic organizations of States members of CMEA is being worked out. The intention is to draw up a uniform regulation, for filling the existing gaps in the general provisions of CMEA's current general conditions, and for restricting the subsidiary use of their regulations, including the national legal rules of States members of CMEA. The Standing Commission is also working on the idea of establishing general conditions for contracts concerning scientific and technical co-operation among economic organizations of States members of CMEA.

10. The Standing Commission on Legal Matters has completed a study of the national legal rules of the States members of CMEA governing agreements for subcontracting, commissions and associations. Work has been initiated on a comparative study of the national legal rules governing contracts for the purchase, sale and transportation of goods. It is intended that the results of this study will be published as a second part of the book entitled "The contract law of the States members of CMEA and Yugoslavia".

### C. International countertrade practices

#### 1. UNCITRAL

11. At the twenty-first session in 1988, the Commission decided that it would be desirable to prepare a legal guide on drawing up countertrade contracts (A/CN.9/302). It was decided that such a legal guide should be prepared by the Commission, and the Secretariat was requested to prepare draft chapters of the legal guide for the twenty-third session of the Commission (A/CN.9/332/Add. 1-7).

#### 2. ECE

12. The ECE Committee on the Development of Trade, Working Party on International Contract Practices in Industry, held its thirty-fourth session in Geneva from 26 to 28 June 1989. At that session it continued its deliberations on the second part of a Guide dealing with international countertrade contracts. For consideration of this subject, the Working Party had before it, *inter alia*, the following documents: "Guide on legal aspects of new forms of industrial co-operation. International contracts: Introduction; Part one: Counterpurchase" (TRADE/WP.5/R.4) and "Guide on legal aspects of new forms of industrial co-operation. International countertrade contracts: Part two: Buyback". The Working Party requested the Secretariat to prepare for the thirty-fifth session of the Working Party a new version of document TRADE/WP.5/R.4, reflecting the deliberations of the Working Party at its thirty-fourth session. The Working Party also had a general discussion on the part of the Guide which deals with international co-production and marketing contracts. It requested the Secretariat to prepare a draft on that part

of the Guide for the thirty-fifth session of the Working Party (TRADE/WP.5/30).

13. The Working Party held its thirty-fifth session from 27 to 29 November 1989. The Working Party had before it, *inter alia*, a new version of the document "Guide on legal aspects of new forms of industrial co-operation. International Countertrade Contracts: Introduction; Part One: Counterpurchase" (TRADE/WP.5/R.4/Rev.1) and a new version of the document "Guide on legal aspects of new forms of industrial co-operation. International Countertrade Contracts: Part Two: Buyback" (TRADE/WP.5/R.5). The Working Party requested the Secretariat to prepare for the thirty-sixth session of the Working Party a final version of document TRADE/WP.5/R.4/Rev.1, and a new version of document TRADE/WP.5/R.5, both reflecting the deliberations of the Working Party at the thirty-fifth session (TRADE/WP.5/32).

### 3. UNCTAD

14. At its fourth session held from 18 to 29 November 1985, the UNCTAD Committee on Economic Co-operation among Developing Countries requested the UNCTAD Secretary-General to study and evaluate the contribution that trade practices such as countertrade, joint import procurement, long term contracts, buy-back arrangements, and similar arrangements could make to trade expansion and promotion among developing countries and to recommend ways and means to ensure that such contribution would be positive (resolution 2(a)(iii)). In accordance with that resolution, the UNCTAD Secretariat has been undertaking a number of legal studies and other activities, such as: "Countertrade policies and practices by selected African and Latin American Countries" (UNCTAD/ST/ECDC/32); "Countertrade—Background note by the UNCTAD Secretariat" (TD/B/C.7/82); "Countertrade policies and practices in selected Asian Countries" (UNCTAD/ECDC/176/Corr.1); "Countertrade regulations in selected developing countries" (UNCTAD/ECDC/200); Asian and Pacific regional workshop on countertrade, held at Beijing, China, from 30 November to 6 December 1987 (UNCTAD/ECDC.192); Afro-Latin American Seminar on trade expansion through countertrade and other non-traditional methods, held in Rio de Janeiro, Brazil from 7 to 11 August 1989 (UNCTAD/ECDC/205). In addition, the UNCTAD Secretariat is preparing a study of typology of model contract clauses for countertrade and is organizing an *ad hoc* expert group meeting in order to advise the Secretariat on model contractual clauses of countertrade and related legislation and on methods of financing of countertrade.

#### D. UNIDROIT: principles for international commercial contracts

15. The UNIDROIT Study Group on progressive codification of international trade law continued its work on general principles applicable to international commercial contracts. The Group held its twelfth meeting from 3 to 7 July 1989. The meeting examined the revised articles and draft explanatory report of Chapter V, Section I: perform-

ance in general, and approved the articles in their final version. The next session of the Working Group will be held in Rome from 30 April to 5 May 1990 and will be devoted to an examination of the revised draft articles and draft explanatory report of Chapter III: Interpretation, of Chapter V, Section 2: Hardship and of Chapters VI, Section 1: General provisions on non-performance (UNIDROIT 1990 CD.69-Doc.6).

#### E. ICC: liquidated damages and penalty clauses

16. The ICC Commission on International Commercial Practice has completed a guide on "Liquidated Damages and Penalty Clauses" (ICC Publication No. 478). The Guide examines the state of the law on liquidated damages and penalty clauses in some of the legal systems most important to international trade. It also provides information and comments to practitioners concerned with the drafting of such clauses. The Guide is of a summary nature and the information provided is intended to draw the attention of draftsmen of contracts to the main points in the major legal systems, and particularly to rules of a mandatory nature or otherwise representing pitfalls to an uninformed trader. At a future date it is intended to include as an appendix to the main text of the Guide a brief survey or description of penalty clauses.

#### F. ICC: Incoterms

17. The ICC Working Party on Trade Terms, at the end of 1989, completed its work on the updating and revision of the 1980 edition of INCOTERMS. The revision contains several important changes. First, certain terms have been consolidated: e.g. "FOB Airport" and "FOR/FOT" have been incorporated into a wider "Free carrier" clause. Second, the terms have been rearranged under new headings according to the type of obligations assumed by the seller: e.g. all "D" or Delivery terms fall under a single category. Third, sellers' and buyers' obligations have been more clearly profiled, being laid out in a step by step checklist, whereby each party's obligations are "mirrored" in the other party's response. The new edition has also recognised that an EDI (electronic data interchange) message is equivalent to a document and incorporates the possibility of EDI usage into the body of a text. Additionally, in order to clearly delineate the dividing line between buyers' and sellers' responsibilities, the layout for INCOTERMS 1990 has been completely redesigned to provide for improved clarity and presentation of the rules. Finally, changes have been made in order to reflect evolution in international trading conditions that have taken place since the last edition.

#### G. ICC: retention of title

18. The ICC Commission on International Commercial Practice published in July 1989 a "Guide on Retention of Title" as prescribed by national legislation in 19 countries (ICC Publication No. 467). The Guide was elaborated by its Working Party on Retention of Title (ROT). It explains different national practices, laws and regulations on retention of title. The Guide also provides sample clauses,

specifically on export sales, to serve as a practical tool for exporters, buyers, bankers, lawyers and other parties involved in drafting and interpreting international sales contracts. A bibliography for further reading is also supplied. The Guide is available in English and French. The Working Party has already commenced work on a second edition, which will reflect legislative changes in those countries dealt with in the first edition, and will be expanded to cover legislation in a further 20 countries.

## H. Commercial agents and distributorships

### 1. UNIDROIT: agency in the international sale of goods

19. At its 66th session held in September 1987, the Governing Council of UNIDROIT noted that a Directive on the Coordination of the Laws of the Member States Relating to Self Employed Commercial Agents had been adopted by the Council of the European Communities on 18 December 1986. In these circumstances it authorized the Secretariat to commission a study on the internal relations between principals and agents in the international sale of goods. The study was considered by the Council at its 68th session in April 1989. The study had annexed to it a draft Convention on Contracts of Commercial Agency in the International Sale of Goods. The Secretariat circulated the study and the preliminary draft Convention (study LXXI Doc. 1) to Governments and to interested circles in November 1989 and will prepare a document analysing the reactions thereto for consideration by the Council at its 70th session in 1991 (UNIDROIT 1990 C.D.69 Doc. 1).

### 2. ICC: commercial agency; distributorship

20. The ICC has published a "Guide for Drawing up Contracts for Commercial Agencies" (ICC Publication No. 410) and a "Guide to Drafting International Distributorship Agreements" (ICC Publication No. 441). The Working Party on Commercial Agency Agreements is drafting a model agency contract. The model takes into account the interests of both the principal and the agent and provides an equitable basis for their trading relationship. The model is in harmony with the recent EC directive on self-employed commercial agents. The Working Party expects to complete work on the model contract in 1990.

## I. UNIDROIT: franchising contracts

21. At its 67th session the Governing Council requested the Secretariat to obtain information on the subject of franchising, particularly with regard to the actual content of franchising contracts in different countries. At its 68th session in April 1989 the Governing Council considered the result of an examination of franchise contracts from 12 different countries, as well as of the text of the newly adopted EEC regulation exempting certain categories of franchise agreements from the application of article 85(3) of the Treaty of Rome. The Governing Council decided that franchising should remain on the Work Programme.

## II. COMMODITIES

### A. UNCTAD: Common Fund for Commodities

22. The UNCTAD Agreement establishing the Common Fund for Commodities concluded on 27 June 1980 (TD/IPC/CF./CONF/25, United Nations publication, Sales No. E.81.II.D.8) entered into force in June 1989. The first annual meeting of the Governing Council of the Common Fund was convened by the Secretary-General of UNCTAD pursuant to paragraph 2(b) of the resolution adopted by the United Nations Negotiating Conference on a Common Fund on 27 June 1987 and was held in Geneva from 10 to 21 July 1989. At that meeting it was decided that the location of the headquarters of the Fund would be in Amsterdam and a Managing Director was appointed. The Governing Council elected twenty-six Executive Directors and their Alternates to the Executive Board of the Common Fund (UNCTAD Bulletin No. 254—July/August 1989).

### B. UNCTAD: commodity agreements

23. The aims of the international commodity agreements vary from one agreement to another. The principal objectives, however, are price and export earnings stabilization and long-term development. The latter comprises activities related to improved market access and supply reliability, increased diversification and industrialisation, augmented competitiveness of national products *vis-à-vis* synthetics and substitutes, improved marketing, and distribution and transport systems. International commodity agreements may have additional objectives, e.g. the increase of consumption, the prevention of unemployment or underemployment, and the alleviation of serious economic difficulties.

24. The following commodity agreements have been adopted at various United Nations Conferences under the auspices of UNCTAD, pursuant to the objectives adopted by UNCTAD in resolutions 93(IV) and 124(V) on the Integrated Programme for Commodities:

— *Cocoa*: The International Cocoa Agreement 1986 entered into force provisionally on 20 January 1987 in accordance with a decision taken pursuant to article 70, paragraph 3, of the Agreement. It is due to expire on 30 September 1990 unless extended by decision of the International Cocoa Council. The maximum period of extension provided for in the Agreement is three years.

— *Copper*: The United Nations Conference on Copper, held under UNCTAD auspices from 13 to 24 June 1988 and from 20 to 24 February 1989, adopted a final resolution to which were annexed the terms of reference of the International Copper Study Group. The objectives of the International Copper Study Group are to ensure enhanced international co-operation on issues concerning copper by improving the information available on the international copper economy and by providing a forum for intergovernmental consultations on copper. In addition, the Group may apply to be

- designated as an International Commodity Body under article 7(9) of the Agreement establishing the Common Fund for Commodities, for the purpose of sponsoring projects on copper to be financed by the Fund through its Second Account.
- *Iron ore*: The third session of the Intergovernmental Group of Experts on Iron Ore, established pursuant to a recommendation by the Fourth Preparatory Meeting on Iron Ore under the Integrated Programme for Commodities, was held from 16 to 20 October 1989. At that session, the Intergovernmental Group of Experts recommended to the Trade and Development Board that UNCTAD's work on iron ore should be maintained and that regular intergovernmental meetings of experts should be convened, with the participation of industry advisers, to exchange views on the iron ore situation and to review and enhance iron ore statistics.
  - *Jute*: The International Agreement on Jute and Jute Products, 1982, entered into force provisionally on 9 January 1984 for a period of five years, in accordance with a decision taken pursuant to article 40, paragraph 3, of the Agreement. It entered into force definitively on 26 August 1986 in accordance with article 40, paragraph 1, of the Agreement and was subsequently extended for a period of two years to 8 January 1991, by a decision of the International Jute Council at its tenth session in November 1988. The 1982 Agreement was renegotiated at the United Nations Conference on Jute and Jute Products, 1989, which was held under UNCTAD auspices from 30 October to 3 November 1989. The main features of the International Agreement on Jute and Jute Products, 1989 are much the same as those of the 1982 Agreement. It maintains the same basic aims and provides for the same means to achieve them.
  - *Natural rubber*: The International Natural Rubber Agreement, 1987, entered into force provisionally on 29 December 1988. It subsequently entered into force definitively on 3 April 1989 and will expire on 28 December 1993 unless extended by decision of the International Natural Rubber Council.
  - *Nickel*: The United Nations Conference on Nickel, held under UNCTAD auspices from 28 October to 7 November 1985 and from 28 April to 2 May 1986, negotiated the text of the Terms of Reference of the International Nickel Study Group. The objectives of the Study Group are to ensure enhanced international co-operation on issues concerning nickel, in particular by improving the information available on the international nickel economy and by providing a forum for intergovernmental consultations on nickel. The Terms of Reference have not come into effect. It is envisaged that a meeting of those States that have notified their acceptance of the Terms of Reference will be held in 1990 with a view to putting the Terms of Reference into effect among themselves.
  - *Olive oil*: The International Agreement on Olive Oil and Table Olives, 1986, which was negotiated under UNCTAD auspices, entered into force provisionally on 1 January 1987 and will expire on 31 December 1991 unless extended by a decision of the International Olive Oil Council.
  - *Sugar*: The International Sugar Agreement, 1987, entered into force provisionally on 24 March 1988 in accordance with a decision taken pursuant to article 39, paragraph 3, of the Agreement. The Agreement is due to expire on 31 December 1990 unless extended by decision of the International Sugar Council.
  - *Tin*: The Sixth International Tin Agreement, negotiated under UNCTAD auspices in 1981, expired on 30 June 1989. Buffer stock operations under that Agreement were suspended in October 1985 and the liabilities of the International Tin Council resulting from that suspension have been the subject of litigation in the United Kingdom courts since that time. Despite the expiry of the Agreement, the International Tin Council remains in being for the purpose of liquidation. A United Nations Conference on Tin was convened under UNCTAD auspices in 1988 to negotiate the establishment of an intergovernmental producer/consumer forum for tin. On 7 April 1989 the Conference adopted a final resolution to which were annexed the terms of reference of the International Tin Study Group. The objective of the proposed Group is to enhance international co-operation on issues concerning tin, by improving the information available on the international tin economy and by providing a forum for intergovernmental consultations on tin. The Group may apply to be designated as an International Commodity Body (ICB) under article 7(9) of the Agreement establishing the Common Fund for Commodities, for the purpose of sponsoring, on such terms and conditions as the Group may determine only by consensus, projects on tin to be financed by the fund through its Second Account. The requirements for entry into force of the terms of reference had not been met by the target date of 31 December 1989. Consequently, the Secretary-General of the United Nations will, at an appropriate time, invite those States and intergovernmental organizations that have notified their acceptance of the terms of reference to decide whether or not to put the terms of reference into force among themselves.
  - *Tropical timber*: The International Tropical Timber Agreement, 1983, entered into force provisionally on 1 April 1985 for a period of five years. At its sixth session, in May 1989, the International Tropical Timber Council decided to extend the Agreement for a period of two years ending on 31 March 1992.
  - *Tungsten*: At its twenty-first session in December 1989, the UNCTAD Committee on Tungsten requested the Secretary-General of UNCTAD to approach the Common Fund informally in order to seek its view on the eligibility of the Committee to be designated as an International Commodity Body in accordance with the criteria set out in schedule C of the Agreement establishing the Common Fund for Commodities. The next session of the Committee is scheduled to be held in December 1990.

### C. UNCTAD: complementary facility for commodity-related shortfalls in export earnings

25. The Intergovernmental Group of Experts on the Compensatory Financing of Export Earnings Shortfalls concluded its work at its resumed second session, 10 to 18 April 1989. At that session the Group, *inter alia*, recognized that compensatory financing could be commodity-related addressing some aspects of the instability problems in the commodity sector. Recognizing the value of the existing commodity-related schemes, namely the EEC/ACP STABEX and SYSMIN, STABEX-LDC-ALA and the new programme of Switzerland, the Group underlined that those schemes were limited in their product and country coverage and recommended that other developed countries be invited to consider the possibility of introducing other schemes. The Group also recommended that the problem of commodity export earnings shortfalls of developing countries arising from export earnings instability, as well as actions taken or required in the area of compensatory financing of export earnings shortfalls, be kept under continuous review in UNCTAD, and that the UNCTAD Secretariat be requested to follow developments in various compensatory financing schemes and their implications for the development of developing countries. The report of the Group will be considered by the UNCTAD Trade and Development Board at a special session on 8 and 9 March 1990.

### D. UNCTAD: Global System of Trade Preferences (GSTP)

26. The Global System of Trade Preferences (GSTP) adopted and opened for signature in 1988 (UNCTAD GSTP/MM/BELGRADE/3) entered into force on 19 April 1989 (UNCTAD Bulletin No. 252—May 1989).

### E. UNCTAD: Generalized System of Preferences (GSP)

27. The UNCTAD Special Committee on Preferences convened for its sixteenth session from 24 April to 3 May 1989. It had before it the "Twelfth General Report on the Implementation of the Generalized System of Preferences" (TD/B/C.5/122 and Add.1) which updated the trade effects of the system and highlighted the changes, improvements in the various schemes and provided statistics on non-GSP covered products which indicated that most developing countries, particularly the least developed countries, could benefit from an extension of GSP to such products without significant domestic impact in the preference-giving countries.

28. The Committee also considered a report (TD/B/C.5.121) which analyses the extent to which the multilaterally agreed principles relating to the generalized, non-discriminatory and non-reciprocal character of GSP have been complied with in the improvements of the autonomous GSP schemes since their inception. That report concludes that most of the schemes have been improved as regards product coverage, depth of tariff cuts, and to some extent the rules of origin. However, it indicates that

there also have been significant deviations from the agreed principles: the principle of generalization has proved impossible to implement and almost all GSP schemes continue to carry elements of discrimination. Differential application of preferential treatment among beneficiaries through the introduction of various discriminatory measures, most notably graduation measures, has weakened the stability and effectiveness of the system. The principle of non-reciprocity has been complied with under most schemes, though recently reciprocity has become an overt feature of some schemes as a condition of the continuation of GSP benefits.

29. The Committee agreed that preference-giving countries should in the maintenance, operation and improvement of their autonomous GSP schemes strictly comply with the multilaterally agreed principles relating to their generalized, non-discriminatory and non-reciprocal character. It also invited preference-giving countries to consider improving their autonomous GSP schemes by simplification, greater transparency and stability. The Committee finally recommended that special consideration be given to products of export interest to the least developed countries and addressed the issue of improving the effectiveness of the UNCTAD Technical Co-operation Programme on the GSP, including an invitation to UNDP and individual countries to consider providing resources in support of the Programme. A comprehensive review of the system's second decade will take place in 1990 (UNCTAD Bulletin No. 252—May 1989).

## III. INDUSTRIALIZATION

### A. UNCTAD: economic co-operation and integration among developing countries

30. In accordance with the work programme approved by the UNCTAD Committee on Economic Co-operation among Developing Countries the UNCTAD Secretariat has prepared a publication entitled "Economic Cooperation and Integration among Developing Countries: Compilation of the Principal Legal Instruments". This compilation reproduces the main legal instruments governing the various economic and integration groupings and arrangements among developing countries. The Latin American region comprises four volumes (TD/B/C.7/51(Part I)/Add.1 (Vols. I, II and III and IV)); the African region five volumes (TD/B/C.7/51(Part II)/Add.1 (Vols. I, II/A, II/B, IV and V)) and the Asian and Pacific region one volume (TD/B/C.7/51(Part III)/Add.1 (Vol. I)). In addition, the compilation includes a draft model bilateral agreement prepared on the basis of the compiled agreements. The UNCTAD Secretariat is preparing the meeting of the coordination committee charged with the preparation of the first regional conference of African trading enterprises, to be held in April 1990.

### B. UNIDO: system of consultations

31. A report on "Trade and trade-related aspects of industrial collaboration at the enterprise level" (ID/B/348) was submitted to the Industrial Development Board—the

governing body of UNIDO—at its nineteenth session. In accordance with the recommendations of the Industrial Development Board, UNIDO has evolved a set of legal materials, including model contracts and clauses, guidelines and checklists for contractual arrangements, according to the requirements of each of the thirteen industrial sectors served by the system of consultations.

32. In addition UNIDO is carrying out a study of trends in international product standards and the implication for regional co-operation among developing countries. The study reviews the definitions and nature of technical standards, their benefits and costs, the standardization processes in developed countries, international standardization, the way in which standards influence markets, regional standards for developing countries and the main issues in standardization for developing countries.

### C. UNCTAD: trade in services

33. The UNCTAD Secretariat has prepared a study on issues raised in the context of trade in services (TD/B/1197). The study concentrates on: (a) definitional issues, (b) trade in services and development, and (c) the issues raised by proposals for an increased liberalization of trade in services focusing upon: (i) the techniques and modalities envisaged to achieve such liberalization, (ii) the expected benefits of liberalization of trade in services, including benefits in terms of expanded trade in services and economic growth; and (iii) the contribution of trade in services to the development of the developing countries.

### D. Guides and guidelines

#### 1. UNIDO: guide to investors

34. UNIDO is updating and revising its booklets called "investor's guides" reported on in A/CN.9/324, para. 38. The booklets are designed to meet the special information needs of a potential investor interested in investment prospects in a given developing country. Each of the booklets contains a brief account of the country, its people and resources, the basic infrastructure, the manner in which its economy has developed over the last few years, its industry, the policies and procedures for industrial licensing and transfer of know-how and the facilities which are available to any one interested in investing in the country.

#### 2. UNIDO: contractual checklist

35. UNIDO is continuing its work on a draft contractual checklist for the elaboration of long-term collaboration arrangements in joint ventures, provision of know-how, training, management and marketing in the development of primary and secondary wood-processing industries.

#### 3. FIDIC: conditions of contract

36. FIDIC in 1989 published a "marked-up copy" of the fourth edition of its "Conditions of Contract for Works of

Civil Engineering Construction" (1987) showing changes from the third edition. FIDIC also published in 1989 a Guide to the use of the fourth edition.

### E. World Bank: Multilateral Investment Guarantee Agency (MIGA)

37. In the previous report (A/CN.9/324, paras. 45 and 46) it was reported that the World Bank Convention to establish a Multilateral Investment Guarantee Agency (MIGA) took effect on 12 April 1988. The objective of MIGA is to encourage the flow of investments for productive purposes among its member countries—in particular, to developing countries. MIGA is intended to enhance mutual understanding and confidence between host Governments and foreign investors and heighten awareness of investment opportunities. To fulfil its purpose, MIGA guarantees eligible investments against losses resulting from noncommercial risks and carries out research and promotional activities. As of June 30, 1989 the Convention had been signed by fifteen category one (capital-exporting) countries and fifty-eight category two (capital-importing) countries. Fifty-two signatory States had also ratified the Convention (*The World Bank Annual Report 1989*).

### F. PTA: trade and investment

38. The PTA is carrying out a study on trade and investment laws of the PTA member States. The study will involve the compilation and analysis of trade and investment laws. The main objective of the study is to provide a convenient compendium of these laws for the guidance of traders and investors from within and outside the member States.

### G. Joint ventures

#### 1. AALCC: industrial joint ventures

39. The Sub-Committee on International Trade Law Matters of the AALCC is continuing its work on the legal framework for industrial joint ventures. At the twenty-eighth session of the AALCC held in Nairobi in February 1989 the Committee decided to continue the work started at its Arusha session (1986) and is now in the process of formulating a legal guide on industrial joint ventures.

#### 2. ICC: East-West joint ventures

40. The previous report (A/CN.9/324, para. 48) announced that the ICC had published a "Guide for Joint Ventures Between Soviet State Enterprises and Western Firms". The book was produced by a task force from the ICC and the USSR Chamber of Commerce and Industry (ICC publication No. 456). After the publication of the Guide the task force began an evaluation on the experiences of existing joint ventures. The evaluation is designed to assist in the task force's formulation of a more up-to-date guide to joint ventures which is already under

way. The task force is further considering work on joint ventures and free economic zones and licensing procedures affecting products.

### 3. *PTA: charter on multilateral enterprises*

41. The PTA Secretariat and the United Nations Centre on Transnational Corporations (CTC) are conducting a study which will be the basis for the drafting of a Charter on Multinational Industrial Enterprises (MIEs). The Charter's main objective is to promote cross border joint ventures by the nationals (juridical and natural) of the PTA member States as well as intra-State joint ventures. The Charter will address such issues as procedural rules concerning the establishment and approval of MIEs, the legal personality and status of the companies, minimum conditions which must be met before a company can qualify as an MIE under the Charter, incentive arrangements, benefits and guarantees to be accorded to MIEs, obligations to be imposed on MIEs, dispute settlement procedures, guidelines for the identification of industrial projects which may be of interest to investors under the MIEs regime, and guidelines on negotiations on the establishment of joint ventures.

### 4. *UNCTAD: joint ventures*

42. In accordance with the work programme approved by the UNCTAD Committee on Economic Co-operation among Developing Countries at its third and fifth sessions (resolutions 2(III) (a) (ii) and 4 (v), para. 4 (b) (ii)), the UNCTAD Secretariat initiated a series of publications whose purpose has been to describe and compile the regulations concerning foreign investments in developing countries. At present three volumes have been published relating to regulations of African countries (UNCTAD/ST/ECDC/30, UNCTAD/ST/ECDC/30/Add.1, UNCTAD/ST/ECDC/30 (Part II)), one volume relating to regulations of Asian countries (UNCTAD/ST/ECDC/43 (Part I)) and another relating to regulations of Arab Countries (UNCTAD/ST/ECDC/42 (Part I)). Subsequently this study will be extended to include the Latin American and Caribbean region. The UNCTAD Secretariat is preparing a study on the impact of existing foreign investment laws and regulations in developing countries on the flow of foreign investment to these countries and is organizing an expert group meeting in order to analyse the findings of the studies on foreign investment regulations and the impact of those regulations in developing countries and formulate recommendations to expand investments to those countries.

43. The UNCTAD Secretariat has been undertaking studies on institutional and legal aspects relating to the promotion of multilateral and joint ventures among developing countries such as: "Juridical aspects of the establishment of multinational enterprises" (TD/B/C.7/28.Rev.1); "Latin American multinational enterprises: an analytical compendium" (TD/B/C.7/50); and "South-Saharan African multinational enterprises" (UNCTAD/ECDC/201).

### 5. *CMEA: joint ventures*

44. The CMEA's Standing Commission on Legal Matters is engaged in the preparation of information and reference materials on the legislation of individual countries in respect of the legal regulation of the arrangements for, and the operation of, direct production and scientific and technical links among enterprises and organizations of States members of CMEA and Yugoslavia, and on the legal rules regulating matters relating to the establishment and operation of their joint ventures, associations and organizations.

## IV. TRANSNATIONAL CORPORATIONS

### A. *CTC: draft Code of Conduct on Transnational Corporations*

45. Work on the draft Code of Conduct on Transnational Corporations being carried out by the Centre on Transnational Corporations (CTC) reported on in the previous report (A/CN.9/324, paras. 49 and 50) is continuing.

46. Under the sponsorship of the International Law Association's Committee on the Legal Aspects of the New International Economic Order, and the Centre on Transnational Corporations, a group of prominent international lawyers from diverse national and legal backgrounds participated in a symposium on the current status of the draft United Nations Code of Conduct on Transnational Corporations. The Symposium was held in September 1989 at the Hague. The focus of attention was on the outstanding issues in the negotiations for the Code of Conduct, although the participants also addressed the need for such a code and the prospects for its finalization.

47. The outstanding issues in the Code of Conduct have important implications for international law, and the principal objective of the Symposium was to invite distinguished and experienced international lawyers to review these issues, the divergent positions of the negotiating parties and the various formulations with a view to making an overall assessment as to whether the basic approach of the CTC in the formulation of the various provisions was feasible or otherwise flawed on technical grounds. The participants found no fundamental technical flaw in the basic approach of the Commission on Transnational Corporations as to the outstanding issues. The essential format of the provisions of the outstanding issues was considered feasible. The outstanding issues in this regard are: 1. The question of a reference to international law/international obligations, 2. non-interference in national political affairs, 3. respect for national sovereignty, 4. nationalisation and compensation, 5. dispute settlement, 6. national treatment. The outstanding issues were also discussed at the meeting of the enlarged Bureau of the Special Session of the Commission on Transnational Corporations at its meetings held in January 1990.

48. The participants endorsed the validity of the Code exercise in the contemporary international economic environment. The participants further considered that current international developments such as the increased



internationalization of economic activities, the phenomenal growth in the volume of trade and foreign direct investment (FDI) flows, the emergence of services as an important component of FDI and trade, and indeed the entire phenomenon of increasing interdependence in the world economy all underscored the importance of transnational corporations as major actors in the world economy. Those trends reinforced the need for an international framework for the operations of TNCs.

### B. CTC studies

49. CTC publications and studies have continued to give major focus to the role and impact of transnational corporations (TNCs) on national and regional investment and in specific sectors. In detailed analyses, examination is made of legal, economic and social factors impacting on TNCs in host countries. Relevant legal issues are observed and analysed, as well as their trends and implementation. The harmonization/nationalization of national and regional laws and regulations are monitored by CTC, and are coordinated on a global basis.

50. Special studies of CTC completed and published in 1988 and 1989 are:

1. International Income Taxation and Developing Countries (Sales No. E.88.II.A.6)
2. International Accounting and Reporting Issues: 1987 Review (Sales No. E.88.II.A.8).
3. Transnational Corporations: A Selective Bibliography, 1983-1987, Vol. I (Sales No. E.88.II.A.9) and Vol. II (Sales No. E.88.II.A.10).
4. Transnational Corporations in World Development: Trends and Prospects—Executive Summary (Sales No. E.88.II.A.15).
5. Conclusions on Accounting and Reporting by Transnational Corporations: The Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (Sales No. E.88.II.A.18).
6. Data Goods and Data Services in the Socialist Countries of Eastern Europe (Sales No. E.88.II.A.20).
7. Foreign Direct Investment and Transnational Corporations in Services (Sales No. E.89.II.A.1).
8. International Accounting and Reporting Issues: 1988 Review (Sales No. E.89.II.A.3).
9. The Process of Transnationalization and Transnational Mergers (Sales No. E.89.II.A.4).
10. Transnational Corporations and the Growth of Services: Some Conceptual and Theoretical Issues (UNCTC Current Studies, Series A, No. 9) (Sales No. E.89.II.A.6).
11. Transnational Corporations in the Construction and Design Engineering Industry (Sales No. E.89.II.A.6).
12. National Legislation and Regulations Relating to Transnational Corporations Vol. VII (Sales No. E.89.II.A.9).

13. International Debt Restructuring: Substantive Issues and Techniques (Sales No. E.89.II.A.10).
14. Transnational Corporations in South Africa and Namibia: A Selective Bibliography (Sales No. E.89.II.A.13).
15. Transnational Service Corporations and Developing Countries: Impact on Policy Issues (Sales No. E.89.II.A.14).
16. Transnational Corporations and International Economic Relations: Recent Developments and Selected Issues (Sales No. E.89.II.A.15).
17. Services and Development: The Role of Foreign Direct Investment and Trade (Sales No. E.89.II.A.17).
18. Objectives and Concepts Underlying Financial Statements (Sales No. E.89.II.A.18).

51. Special studies of CTC completed in 1989 and to be published in 1990 are:

1. Negotiating Hotel Management Agreements.
2. Key Concepts in International Investment Arrangements and their Relevance to International Transactions in Services.
3. Licence and Contract Terms for Petroleum Exploration.

## V. TRANSFER OF TECHNOLOGY

### A. UNCTAD: proposed international code of conduct on the transfer of technology

52. UNCTAD has continued in its work to negotiate and adopt an international code of conduct on the transfer of technology mandated by the General Assembly by resolution 32/188 of 19 December 1977. Divergencies in approach exist in several areas such as restrictive practices and applicable law.

53. New factors have made a compromise on the issues outstanding more difficult to obtain. Technological changes and innovation in general are being universally recognized as fundamental to economic growth and development and as key factors in international trade and in competitiveness among nations. With that objective in mind and with a view to encouraging technological progress, anti-trust legislation dealing with restrictions on technology licensing is being liberalized in key developed countries. Another significant development is the importance being attached to the reinforcement of the legal protection of technological assets particularly in high technology. Related to that factor is the importance attached by a number of countries to trade-related aspects of intellectual property protection.

54. UNCTAD recently published two reports in the area of technology transfer. These are:

- Technological innovation policy in France: Measures and instruments (UNCTAD/TTP/TEC/1).
- Impact of technological change on patterns of international trade (UNCTAD/TTP 116).

## B. UNCTAD: industrial property system and transfer of technology to developing countries

55. UNCTAD continues to examine the economic, commercial and development aspects of the industrial property system, patents and trade marks and to contribute to the current revision of the Paris Convention for the Protection of Industrial Property. The first in the series of Round Tables organized under the UNCTAD/UNDP Inter-regional Project for the Multilateral Trade Negotiations, on the subject of Technology and Trade Policy, was held at the European Cultural Centre in Delphi, Greece, from 22 to 24 April 1989. The Round Table was co-hosted by the University of Athens and the European Cultural Centre, Delphi. Two Working Sessions were held, dealing respectively with the "new issues" on the agenda of the Uruguay Round, namely trade in services, trade-related aspects of intellectual property rights (TRIPS), and trade-related investment measures (TRIMS) (UNCTAD Bulletin No. 253—June 1989).

## C. UNIDO: Guide to Guarantee and Warranty Provisions on Transfer of Technology Transactions

56. UNIDO and the International Center for Public Enterprises in Developing Countries (ICPE) in January 1990 jointly published a "Guide to Guarantee and Warranty Provisions on Transfer of Technology Transactions" (ID/355). This work is meant to be a legal and managerial guide reflecting the concerns of developing countries and elaborates in detail on the importance and scope of guarantee provisions which in developing countries comprise a wider field than in industrialized countries due to a number of structural differences; it also deals with such matters as purpose and function, the present legal situation and contractual practices, and problems and possible solutions to a number of guarantee issues.

## D. UNIDO: Regulatory Rules and Practices on Transfer of Technology

57. UNIDO is launching a monograph series of country studies on "Regulatory Rules and Practices on Transfer of Technology". The series is intended to provide factual data on regulatory practices related to technology transfer negotiation and is especially addressed to representatives of the business community who carry out complex undertakings involving technology transfer to developing countries. The series will contain, among others, the following elements:

- updated information on existing laws and regulations on technology transfer;
- concise description of the basic principles of the regulatory framework as well as changes in the legal and institutional framework which have taken place in the last decade;
- detailed information on jurisprudence, i.e. the ways and modalities of application of law with respect to technology transfer by the respective regulatory agencies.

## VI. INDUSTRIAL AND INTELLECTUAL PROPERTY LAW

### A. UNESCO: copyright and neighbouring rights

58. Since the beginning of the 1980s the United Nations Educational, Scientific and Cultural Organization (UNESCO) and the World Intellectual Property Organization (WIPO) have been engaged jointly in a study designed to recommend solutions for national copyright and neighbouring rights laws with regard to the new uses of protected subject matters (mainly cable television, broadcasting through fixed-service satellites and direct broadcast satellites, use of computers for access to, and the creation of, works rental, and lending). Beginning in 1986 specific problems were studied according to main categories of works. Certain principles of protection accompanied by comments emerged from the above studies and were further perfected, consolidated and submitted for discussion by a committee of governmental experts in June-July 1989. The principles and comments (UNESCO/WIPO/CGE/SYN/3-I, II, III and 4) were distributed to UNESCO and WIPO member States and to intergovernmental and international non-governmental organizations concerned. In the light of those principles, WIPO expects to draft model provisions for national copyright legislation based on a consistent and dynamic interpretation of the Berne Convention.

59. UNESCO continued its assistance to developing countries in advising them on the measures necessary for the application of the international instruments in the field of copyright and in helping them formulate national policies in that field in the light of their national objectives and corresponding to current international standards and to establish appropriate machinery and infrastructures for the administration and management of copyright and the training of copyright specialists. This is being done through advisory services and the holding of seminars in various parts of the world. UNESCO is also involved in the development of teaching of copyright and neighbouring rights in universities in developing countries following a recommendation by the World Congress on Education and Information in the Field of Copyright. An initial educational project was studied at a meeting held in 1988 in Santo Domingo. A basic manual for teaching copyright at Master's degree level is currently being prepared. Audio-visual teaching materials are also being prepared for the same purpose.

60. UNESCO published in 1988 a comparative law study on the "Major Principles of Copyright and Neighbouring Rights in the World". The study is available in English and French. A study entitled "The International Dimensions of Copyright" requested in 1987 by the World Congress on Education and Information in the Field of Copyright is now being prepared. It will be available in 1990-1991. A booklet to promote the Multilateral Convention for the Avoidance of Double Taxation of Copyright Royalties was published in 1988 in English, French and Spanish. In addition to the English-language compilation of "Copyright Laws and Treaties of the World" the French version of that publication was published in loose-leaf binder form in 1990. A thematic data bank with research

possibilities is being created on the basis of the aforementioned compilation.

## **B. WIPO: intellectual property activities, counterfeiting and patent classification**

### **1. WIPO: revision of Paris Convention**

61. During 1989 the International Bureau of (WIPO) has been engaged in reviewing treaties administered by WIPO to take account of changing circumstances. The sixth Consultative Meeting on the revision of the Paris Convention took place in September 1989. Its recommendations were submitted to the Assembly of the Paris Union which decided, in October, that a diplomatic conference on the revision is to take place in the 1990-91 biennium.

### **2. WIPO: international patent classification**

62. Work aimed at perfecting the International Patent Classification (IPC) is continuing within WIPO. The revision of the classification results are published, every five years, in a new edition of the IPC. The latest revision period ended at the end of 1989. The objectives of each revision are that the classification reflect the technological changes that have taken place since the preceding revision, that any mistakes or other shortcomings in the preceding edition that come to light with the actual use of the classification be corrected, and that the classification be adapted to the most advanced systems of computerization (WIPO AB/XX/2).

### **3. WIPO: international registration of audiovisual works**

63. A Diplomatic Conference held in April 1989 in Geneva under the auspices of WIPO concluded a Treaty on the International Registration of Audiovisual Works. The Treaty provides for the establishment, under the auspices of WIPO, of an international register of audiovisual works for the purpose of recording, mainly, statements concerning rights in such works, and concerning who is the owner of what rights in which countries. The International Register has a legal effect: statements registered in it must be considered as true until the contrary is proved. The rebuttable presumption thus created does not apply in a State in which the statement cannot be valid under the copyright law or any other law concerning intellectual property rights in audiovisual works in that State; or where the statement is contradicted by another statement recorded in the International Register.

64. The system will be financially self-supporting through fees paid by its users. The International Register will be kept by the International Registry, which will be an administrative unit of the International Bureau of WIPO. The Treaty provides for the setting up, by the Assembly, of a consultative committee consisting of representatives of interested non-governmental organizations. The purpose of that committee is to achieve close co-operation between the Union and the main prospective

users of the Register. The Committee will be consulted, *inter alia*, before determining or changing the system and amounts of the fees. The International Registry will be located in Austria. A treaty to that effect was signed by the Government of Austria and the Director General of WIPO in October 1989.

### **4. WIPO: intellectual property in respect of integrated circuits**

65. The Diplomatic Conference held for the Conclusion of a Treaty on the Protection of Intellectual Property in Respect of Integrated Circuits adopted, on May 26, 1989, a treaty under the title "Treaty on Intellectual Property in Respect of Integrated Circuits". The Treaty obliges the contracting parties to secure, throughout their respective territories, the intellectual property protection of layout-designs (topographies), to provide adequate measures to ensure the prevention of acts considered unlawful under the Treaty and to provide appropriate legal remedies wherever such acts have been committed. Furthermore, the Treaty enables certain intergovernmental organizations to become contracting parties (e.g. the European Communities are eligible) and provides for a mechanism, within the framework of WIPO, for the settlement of possible disputes between contracting parties. The Treaty remains open for signature until May 25, 1990, at the headquarters of WIPO.

### **5. WIPO: harmonization of patent and trade mark laws**

66. Work on the harmonization of patent and trade mark laws continued in WIPO in 1989. The Committee of Experts dealing with patents held its sixth and seventh sessions in April and November, respectively, to consider a draft treaty on the subject. The International Bureau will redraft the articles in the light of the discussions of the above-mentioned two sessions and will submit the new drafts to the eighth session of the Committee of Experts in June 1990, which will examine the new draft of the proposed treaty in preparation for consideration by a diplomatic Conference scheduled for June 1991.

67. Work on the harmonization of trademark laws started in November 1989 when a Committee of Experts held its first session. As in the case of the harmonization of patent laws, the aim is to prepare a draft of a treaty which would supplement the Paris Convention for the Protection of Industrial Property. The treaty should be adopted by a diplomatic conference after 1991. The first session dealt with draft articles on the definition of the notion of mark (trademark and service mark), and the applications for their registration.

### **6. WIPO: copyright legislation**

68. WIPO is engaged in drafting model provisions for legislation in the field of copyright. The Committee of Experts dealing with this matter held its first and second sessions in February/March and November of 1989. The Committee of Experts considered draft model provisions dealing with the subject. The model provisions are in-

tended to inspire and influence governments and legislators to improve their copyright laws and opt for solutions that will increase the degree of similarity among legislation whenever the special interests of a country do not require different solutions. The Committee is scheduled to meet in July 1990 when it should complete its work on the text of the model provisions (WIPO Report of Activities of the International Bureau 1989).

### C. UNIDROIT: international protection of cultural property

69. The UNIDROIT study group on the international protection of cultural property at its third session, held in Rome from 22 to 26 January 1990, approved the text of a draft UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects. The draft Convention which consists of eleven articles will be considered by the Governing Council at its 69th session in April 1990.

## VII. INTERNATIONAL PAYMENTS

### A. UNCITRAL: United Nations Convention on International Bills of Exchange and International Promissory Notes

70. The United Nations Convention on International Bills of Exchange and International Promissory Notes adopted by the General Assembly on 9 December 1988 by resolution 43/165 has been prepared in its definitive form and is available for signature, ratification, acceptance, approval and accession. The Convention is open for signature until 30 June 1990.

### B. Guarantees and stand-by letters of credit

#### 1. ICC: guarantees

71. A Working Party set up by the ICC continued in 1989 to draft rules to cover all forms of guarantees. At the first two meetings the Working Party worked on the basis of earlier ICC rules on this subject and on a Code of Practice presented by the British Bankers Association (BBA) on Demand Guarantees and Bonds. The draft under preparation is to cover all types of guarantees issued by banks, financial institutions and insurers. It is aimed at the needs of principals, beneficiaries and issuing institutions alike. In December 1989 the ICC held a symposium in Paris on "Demand Guarantees". The Seminar addressed a variety of issues, namely on the legal relationship between the parties, the aims of the principal, the aims of the beneficiary, the guarantor's role and whether a guarantee can really be independent of the underlying contract.

#### 2. UNCITRAL: guarantees and stand-by letters of credit

72. The Commission, at its twenty-second session in 1989, accepted the recommendation of its Working Group on International Contract Practices that work on a uniform

law on guarantees and stand-by letters of credit be undertaken and entrusted that task to the Working Group. The Working Group's thirteenth session was held from 8 to 18 January 1990. It commenced its work by considering possible issues of a uniform law as discussed in the note by the Secretariat (A/CN.9/WG.II/WP.65). The Working Group further engaged in a preliminary exchange of views on further possible issues to be covered by the uniform law (A/CN.9/330).

### C. UNCITRAL: Model Law on International Credit Transfers

73. The Commission decided, at its nineteenth session in 1986, to begin the preparation of model rules on electronic funds transfers and to entrust that task to the Working Group on International Negotiable Instruments, which it renamed the Working Group on International Payments. The Working Group held its nineteenth session from 10 to 21 July 1989 and its twentieth session from 27 November to 8 December 1989, at which it continued its consideration of the draft model law (A/CN.9/328 and A/CN.9/329). The text of the draft Model Law before the Working Group was that set out in the report of the nineteenth session of the Working Group (A/CN.9/328, annex) and reproduced with comments in A/CN.9/WG.IV/WP.44.

### D. ICC: interbank fund transfers

74. The ICC Working Party on International Interbank Fund Transfers continued throughout 1989 to finalize its draft containing Guidelines to banks for interbank transfer instructions. The Guidelines are intended for developing countries which predominantly have no transfer systems of their own. They constitute the first step to enable such countries, without the necessary systems for harmonized interbank transfers and compensation procedures in the event of loss, to process transfers in an internationally acceptable manner. The Guidelines can be applied to a transaction between two banks when the receiving bank has adhered to the Guidelines. Even with the support of 20 countries for the Working Party's draft, there still remained strong opposition by major countries, many of which are responsible for the highest volume of traffic in interbank fund transfers. Members did not feel that the interbank rules would be viable without the support of the major countries and for that reason the Commission decided that the text should be issued as guidelines.

### E. ICC: EDI revision

75. The ICC Commission on International Commercial Practice has set up a working party to prepare rules for an "EDI Credit". It will include representatives of banking, commerce, the various service sectors, e.g. transport, insurance, and Edifact, to consider fully the needs and possibilities in respect of the use of electronic data interchange (EDI) with a view to developing an "EDI Credit" and appropriate uniform rules, bearing in mind both the current problem areas of credit, the technical difficulties

involved in changing to an electronic system, and the basic commercial purpose of credit, whether based on paper or EDI. Such a group will have a carefully thought out composition calling for in particular participation by developing countries.

#### F. ICC: revision of UCP 400

76. The ICC Commission on International Commercial Practice has also agreed to set up a think tank and thereafter a working party to outline the parameters of a UCP 400 revision. It received many proposals for such a revision which without careful discussion could ultimately lead to a rather voluminous manual for documentary credits with a considerable increase in the number of articles. That would create more problems than it solved as the handling of documentary credits would be even more complicated and expensive than at present. In order to simplify both UCP and the documentary credit, and before starting the revision work, ICC will conduct an enquiry worldwide into the prospects of simplification.

### VIII. INTERNATIONAL TRANSPORT

#### A. Transport by sea and related matters

##### 1. UNCTAD: United Nations Convention on Conditions for Registration of Ships 1986

77. Following the adoption of the United Nations Convention on Conditions for Registration of Ships reported in the previous report A/CN.9/324, para. 76, the Convention was signed by 16 countries. As at 31 December 1989, six countries had become contracting parties to the Convention.

##### 2. UNCTAD: Guidelines on Convention on a Code of Conduct for Liner Conferences

78. In accordance with the provisions of article 52 of the Convention on a Code of Conduct for Liner Conferences, a Review Conference was convened in Geneva from 31 October to 18 November 1988 in order "to review the working of the Convention, with particular reference to its implementation and to consider and adopt appropriate amendments". The Conference was attended by 102 States, including 63 States contracting parties. Agreement could, however, not be reached on the rules of procedure which should be applicable to the Review Conference, in particular as regards to the extent to which and manner in which States that were not contracting Parties should be able to participate in decision-making at the Review Conference. Five sets of specific issues relating to implementation and working of the Convention were identified by the UNCTAD Secretariat as appropriate for consideration by the Review Conference. Those covered: the implications for the Convention of the technological and structural changes in world liner shipping; the scope of application of the Convention; reservations to the Convention; modalities of implementation; the activities of non-conference lines in liner trade to which the Convention applies.

79. Views expressed at the Review Conference indicated that there were significant differences between Governments with regard to the two interrelated subjects of the scope of application of the Convention and the treatment of non-conference lines, as well as with regard to the appropriate modalities of implementation of the Convention. The debate on the subject of reservations generally reflected the differences between the shipping interests/objectives of the developed market-economy countries and those of many of the developing countries. As regards technological and structural changes in world liner shipping, developing countries expressed their concern that the speed of such changes tended to affect them adversely with regard to their participation in world liner shipping.

80. At the conclusion of the session, a resolution was adopted unanimously which recognized the continuing validity of the Convention and invited all States that were entitled to become contracting parties, but that had not yet done so, to consider ratifying or acceding to the Convention. The resolution requested the Secretary-General of the United Nations to convene a resumed session of the Review Conference in 1989.

##### 3. UNCTAD/UNCITRAL: Study on the economic and commercial implications of the entry into force of the Hamburg Rules and the Multimodal Transport Convention

81. In the previous report (A/CN.9/324, para. 80) it had been reported that the UNCTAD Secretariat was preparing a study on the economic and commercial implications of the United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg) and the United Nations Convention on Multimodal Transport of Goods (MTO Convention). Part I of the studies dealt with the Hamburg Rules and was prepared in collaboration with the UNCITRAL Secretariat (TD/B/C.4/315 (Part I)). The second part of the study, dealing with the Multimodal Transport Convention, was issued at the end of 1989 for consideration by the fourteenth session of the Committee on Shipping. The two parts will later be combined to form one booklet.

##### 4. UNCTAD/IMO/CMI: maritime liens and mortgages and related subjects

82. The Joint Intergovernmental Group of Experts on Maritime Liens and Mortgages and Related Subjects established by UNCTAD and IMO held its fifth and sixth sessions during 1989. It completed its preparation of a draft set of articles for a convention on maritime liens and mortgages and recommended that the Committee on Shipping of UNCTAD and the Legal Committee of IMO recommend to the relevant bodies of the United Nations the convening of a diplomatic conference for the adoption of the draft Maritime Liens and Mortgages Convention. The Joint Group further recommended that the relevant bodies of UNCTAD and IMO consider making provision for further meetings of the Joint Group to review, in the light of the results of the diplomatic conference, the 1952 Convention Relating to the Arrest of Seagoing Ships, after

the adoption of the final text of the Convention on Maritime Liens and Mortgages (TD/B/C./AC.8/27).

#### 5. UNCTAD: charter parties

83. The twelfth session of the Working Group on International Shipping Legislation which was scheduled to be held in 1989 to deal with the subject of charter parties was postponed until October 1990.

#### 6. UNCTAD: marine insurance

84. The text of the UNCTAD Model Clauses on Marine Hull and Cargo Insurance drafted by the Working Group on International Shipping Legislation and endorsed by the Trade and Development Board was reissued (TD/B/C.5/ISL/50 Rev. 1). The document includes a brief explanation as to the manner in which the Model Clauses can be used by insurance markets.

#### 7. UNCTAD: maritime fraud

85. The Maritime Fraud Prevention Exchange (MFPE) established under the auspices of UNCTAD by private sector organizations (A/CN.9/324, paras. 87 and 88), in an attempt to help in combating maritime fraud by providing a focal point for information, became operational on 1 December 1988. The MFPE has been renamed as the Maritime Advisory Exchange and is located in London.

#### 8. UNCTAD: minimum standards for shipping agents

86. The UNCTAD Minimum Standards for Shipping Agents endorsed by the Committee on Shipping at its thirteenth session in March 1988 were issued in document UNCTAD/ST/SHIP/13. The Minimum Standards are non-mandatory in nature and are to serve as guidelines for national authorities and professional associations in establishing their own standards applicable to shipping agents.

#### 9. UNCTAD: co-operation among developing countries in shipping, ports and multimodal transport

87. In its decision 63 (XIII) on "Economic Co-operation between developing countries in the area of shipping, ports and multimodal transport" the Committee on Shipping requested the Secretary-General of UNCTAD to convene a group of experts to propose an appropriate framework and modalities of interregional co-operation in the field of shipping services, taking into account the recommendations and priorities established by the *ad hoc* Intergovernmental Group of Senior Officials on Co-operation among Developing Countries in Shipping Ports and Multimodal Transport in its resolution 1(I) (TD/B/C.4/AC.9/4). The Group of Experts elaborated recommendations on the framework and modalities of interregional co-operation in shipping services and focused on three main topics: (a) identification of possible areas of co-operation, (b) defining appropriate institutional framework and mechanisms for developing and promoting co-operation, and (c) identifying main obstacles to prerequisites for successful co-operative arrangements. In those recommen-

dations, which will be presented to the fourteenth session of the Committee on Shipping in June 1990, the Group identified a number of possible areas in which developing countries could co-operate, such as:

- (a) Co-operation in operational activities: central freight booking, pooling of cargoes and shipping space, joint ventures, information exchange, multinational companies, research and development, establishment of multimodal transport operators, co-operation in manning, joint financing, determination of base ports/transshipment ports, ship repair and building up of appropriate computer systems;
- (b) Co-operation in training, transfer of know-how;
- (c) Co-operation in policy matters: planning and policy formulation, legislation, harmonization and simplification of procedures;
- (d) Institutional structure: subregional/regional co-operation, interregional co-operation.

#### 10. UNCTAD/ICC: Uniform Rules on Multimodal Transport

88. The UNCTAD Committee on Shipping instructed the UNCTAD Secretariat to produce a multimodal transport document based on the Hague-Visby Rules. The UNCTAD Secretariat, in close co-operation with ICC and FIATA, is now in the process of drafting new uniform rules for multimodal transport to replace the existing ICC Uniform Rules.

#### 11. IMO: revision of the Athens Convention Relating to the Carriage of Passengers and their Luggage by Sea, 1974

89. The IMO Council at its fifteenth extraordinary session in October 1989 endorsed the recommendations of its Legal Committee and decided to convene a diplomatic conference in 1990 to revise the Athens Convention.

#### 12. UNCITRAL: draft Convention on Liability of Operators of Transport Terminals in International Trade

90. The Commission at its twenty-second session adopted a draft Convention on Liability of Operators of Transport Terminals in International Trade (A/CN.9/298, annex I). The Commission submitted the draft Convention to the General Assembly with a recommendation that an international conference of plenipotentiaries be convened to conclude a Convention on the Liability of Operators of Transport Terminals in International Trade. The General Assembly, by resolution A/44/33 of 4 December 1989 accepted the recommendation of the Commission and decided that a diplomatic conference would be held from 2 to 19 April 1991 at Vienna.

#### 13. IMO: Convention on Salvage

91. The International Convention on Salvage, 1989 was adopted at a diplomatic Conference held in London from 17 to 28 April 1989 (IMO LEG/CONF. 7/26).

#### 14. CMI: carriage of goods by sea

92. The CMI is giving consideration to the problem of uniformity of the law of the carriage of goods by sea in the 1990s in the light of the international conventions presently in force. A study, based on the Hague-Visby rules, has been prepared by an International Sub-Committee and will be submitted to the 34th International Conference of CMI which will be held in Paris from 24 to 29 June 1990.

#### 15. CMI: sea waybills

93. A Sub-Committee of the CMI has completed preparation of draft uniform rules for incorporation into sea waybills. The draft uniform rules will be presented to the 34th International Conference of CMI which will be held in Paris from 24 to 29 June 1990.

#### 16. CMI: electronic transfer of rights to goods in transit

94. A CMI International Sub-Committee is considering problems arising out of the use of electronic means of transfer of rights to goods in transit. The Sub-Committee has prepared draft rules which should govern the electronic transfer of rights to goods in transit. Those rules will be considered at the 34th International Conference of CMI which will be held from 24 to 29 June 1990.

#### 17. CMI: revision of Rule VI of the York-Antwerp Rules 1974

95. The International Conference on Salvage which was held in London in April 1989 requested the Secretary-General of IMO to take appropriate steps in order to ensure speedy amendment of the York-Antwerp Rules 1974 to ensure that special compensation paid under article 14 of the new Salvage Convention was not subject to general average. The Secretary-General of IMO, in turn, requested the President of the CMI to consider the action required to amend the York-Antwerp Rules. The CMI appointed an International Sub-Committee with the task of considering the problem. The Sub-Committee has prepared a draft text of Rule VI of the York-Antwerp Rules to deal with special compensation payable pursuant to article 14. The draft will be submitted for consideration and approval to the 34th International Conference of CMI which will be held in Paris from 24 to 29 June 1990.

### B. Transport overland and related issues

#### 1. OTIF: Convention Concerning International Transport by Rail (COTIF)

96. The Revision commission set up by OTIF to review the COTIF held its first meetings in December 1989. It adopted in accordance with the simplified revision procedure revised articles of the COTIF concerning the transportation of passengers and luggage and transportation of goods. In accordance with the ordinary revision procedure,

it made proposals for the General Assembly to consider: extending the scope of the COTIF to include the removal and delivery of the goods by means of road transportation; modifying the rules on the transport of automobile vehicles on time limits for reporting on an accident; the amount of damages in case of late delivery; and adopting uniform rules for the conversion of amounts of damages into currencies other than the currencies of award. Those proposals will be discussed at the General Assembly meeting at the end of 1990.

#### 2. UNIDROIT: civil liability for damage caused during carriage of dangerous goods by road, rail and inland navigation vessels

97. A UNIDROIT Committee of Government Experts has completed its work on the preparation of uniform rules relating to liability and compensation for damage caused during the carriage over land of hazardous substances, begun in 1981. A Convention on Civil Liability for Damage caused During the Carriage of Dangerous Goods by Road, Rail and Inland Navigation vessels was adopted on 10 October 1989. The Convention has been opened for signature by all States at Geneva from 1 February 1990 until 31 December 1990 (UNIDROIT 1990 C.D. 69-Doc.6).

#### 3. OAS: Inter-American Convention on Contracts for the International Carriage of Goods by Road

98. The Organization of American States adopted on 14 July 1989, in Montevideo, a convention to regulate contracts for the international carriage of goods by road. The Convention applies to carriage of goods where the place of dispatch of the goods is in a State party to the Convention and that of deliveries in another State party, even when the vehicle used is itself carried, for a portion of the route, via some other mode of transportation without the goods being unloaded, or when carriage is performed by joint services. The rules of the Convention do not limit the rules of bilateral or multilateral Conventions between the States Parties concerning the international transportation of goods or more favourable practices that those States may observe in relation thereto.

## IX. INTERNATIONAL COMMERCIAL ARBITRATION

### A. AALCC: regional arbitration centres

99. The Asian-African Legal Consultative Committee (AALCC) in 1977 adopted a scheme for the establishment of regional arbitration centres. In 1978 the Kuala Lumpur Centre and in 1979 the Cairo Centre were established. A third centre in Lagos, Nigeria was inaugurated in March 1989. All three centres conduct their arbitrations under the UNCITRAL Arbitration Rules, as supplemented by internal or administrative rules of the centres.

100. The AALCC is also involved in dissemination of information relating to international commercial arbitra-

tion. In this regard: (i) The Cairo Arbitration Centre in collaboration with the Jeddah Chamber of Commerce and Industry organized an Arbitrators Training Programme in Jeddah from 6 to 18 November 1989. In May 1989 the Centre initiated the establishment of an Association of Arab and African Arbitrators. In July 1989, the Centre established the "Institute of Investment and Arbitration"; (ii) the Kuala Lumpur Arbitration Centre organized a Conference on International Commercial Arbitration in Kuala Lumpur from 4 to 5 July 1989 which was attended by participants from 13 countries.

#### **B. CMEA: arbitration of disputes arising out of international agreements**

101. In 1988, within CMEA's Standing Commission on Legal Matters, a study on the advisability of settling disputes arising out of international agreements concerning economic, scientific and technical co-operation by means of *ad hoc* arbitration was conducted by interested States members of CMEA. As a result of this study, draft model articles on international *ad hoc* arbitration for inclusion by the parties in the international agreements concluded between them, when they consider this necessary, were prepared, as well as draft regulations governing international *ad hoc* arbitration which may be used in arbitration proceedings if the parties to a particular agreement have not agreed on other rules for the institution and conduct of such arbitration. These texts have been submitted to the Executive Committee of CMEA for approval.

#### **C. ICC: interim and partial awards; dissenting opinions**

102. The Working Party on Partial and Interim Awards and Dissenting Opinions established by the ICC Commission on International Arbitration in 1985 is continuing its studies on the use of interim and partial awards in international commercial arbitration with particular emphasis on the practice of the ICC Court of International Arbitration and ICC arbitrators. The Commission at its meeting held on 19 April 1989 approved the Third Draft and Final Report of the Working Party (ICC Document 420/312). The Working Party is also continuing its work on dissenting and separate opinions. At another meeting on 21 April the Commission discussed the fourth report on the subject by the Working Party (ICC Document No. 420/304).

#### **D. ICC: multiparty arbitration**

103. An ICC Working Party has continued to examine the question of multiparty arbitration. The Working Party is considering the issues raised by multiparty arbitration within the context of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, including the possibility that those issues arise only to the extent that no multiparty arbitration agreement exists, and the feasibility of devising new rules for handling the financial aspects of cases with a multiparty ingredient. In its studies the Working Party stresses the importance of avoiding the paralysing effects resulting

from the multiplicity of parties inherent in multiparty arbitration. The ICC Commission on International Arbitration held a seminar from 29 to 30 May 1989, hosted by the Swedish National Committee of the ICC in Stockholm, on the subject of multiparty arbitration (ICC Document No. 420/308). The Working Party decided at its February 1990 meeting to draft as an aid for counsel and businessmen a new brochure on multiparty arbitration where the main practical and legal questions and pitfalls related to it would be described.

#### **E. ICC: arbitral referee**

104. The ICC Commission on International Arbitration adopted in 1988 draft ICC Arbitral Referee Rules which establish a framework whereby parties may agree that, in a given dispute, one or both of them may request the ICC to appoint an "arbitral referee" prior to any eventual recourse to arbitration or to national courts. The arbitral referee would have the authority to take rapid decisions as necessary to meet urgent problems, such as preserving or recording evidence, or ordering certain steps to be taken, without in any way deciding upon or prejudging the merits of the dispute, that being left for the competent jurisdiction to resolve. The Rules entered into force as of January 1990. They are contained in ICC publication No. 482 presently available in English and French. The publication also contains a suggested standard clause in English, French and German.

#### **F. ICC/CMEA: East-West joint ventures and arbitration**

105. The International Chamber of Commerce and the Chambers of Commerce and Industry of the seven European countries who are members of the Council for Mutual Economic Assistance (CMEA) jointly organized the Vth Seminar on East-West Arbitration which was held in Paris on February 1 and 2, 1990. The topics discussed at the Seminar were: the concept of a joint venture and its legal context; negotiating and drafting the dispute resolution clauses in the joint venture documents; arbitration and possible disputes related to a joint venture in a CMEA country; joint venture and multiparty arbitration in the CMEA countries; resort to State courts in the CMEA countries. At a subsequent meeting, the Working Party on Arbitration within the Liaison Committee of the ICC and the Chambers of Commerce of Socialist Countries for the Development of East-West Trade and Economic Co-operation decided to convey information on East-West arbitration through a special bulletin published under the auspices of the ICC.

#### **G. ICCA: publications and congresses**

106. The International Council for Commercial Arbitration (ICCA) continued to publish the Yearbook Commercial Arbitration. The Yearbook provides comprehensive and up-to-date world-wide information on commercial arbitration. The Yearbook includes national reports on arbitration law and practice, court decisions on the appli-



cation of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, abstracts of arbitral awards from arbitral institutions and *ad hoc* arbitrations, and articles on arbitration rules and practice. The Yearbook entered its fourteenth year in 1989. The last national report was published in Yearbook XIV-1988. The reports are now covered exclusively in ICCA's International Handbook on Commercial Arbitration, a loose leaf series of arbitration statutes and national reports.

107. In 1988 the proceedings of the ICCA IXth International Congress held in Tokyo from 31 May to 3 June 1987, were published as volume no. 4 of ICCA Congress Series. The Tokyo Congress discussed two themes: (a) arbitration in settlement of international commercial disputes involving the Far East, (b) arbitration in combined transportation. The next volume will cover the proceedings of the Xth International Arbitration Congress in Stockholm. The subject of this congress will be (a) preventing delay or disruption of arbitration, (b) effective proceedings in construction cases. The Congress will be held from 28 to 30 May 1990.

#### H. ILA: transnational rules of law

108. A committee of the International Law Association is assembling material and analysing the applicability of transnational rules of law in international commercial arbitration, having regard to the respective practice in civil law and common law countries. A report is being prepared and will be presented at the Association's 64th Conference in Australia in August 1990.

#### I. PTA: regional arbitration centre

109. The PTA Federation of Chambers of Commerce and Industry (PTA/FCCI) established, on 21 November 1987, a regional arbitration body. The PTA Centre, located in Djibouti, adopted the UNCITRAL Arbitration Rules. There is no common legal regime in the PTA region on the recognition and enforcement of foreign arbitral awards. The Council of Ministers of the PTA has urged all PTA Member States, which are not yet parties to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, to accede to it.

### X. PRIVATE INTERNATIONAL LAW

#### A. Hague Conference: law applicable to negotiable instruments

110. The Hague Conference is working on the preparation of a convention on the law applicable to negotiable instruments. A report of the Permanent Bureau on the topic will be released in 1990. A final decision as to whether the matter should be treated in the context of an extraordinary session open to non-member States will be made at a special meeting of the Conference in November 1990. In the making of that decision the status of the

United Nations Convention on International Bills of Exchange and International Promissory Notes will be taken into account.

#### B. Hague Conference: contract practices studies

111. The Hague Conference is working on a number of topics in the area of contract practices. These include: the law applicable to agreements on licensing of technology and on transfer of know-how and the law applicable to unfair competition. The Conference will decide in November 1990 whether one of the two topics should be dealt with at the seventeenth session of the Hague Conference.

### XI. TRADE FACILITATION

#### A. Administrative procedures relating to goods and documents

##### 1. GATT: pre-shipment inspection

112. At GATT, in the context of the Uruguay Round, negotiations are underway in the Negotiating Group on Non-Tariff Measures aimed at reaching agreement on a multilateral instrument on pre-shipment inspection.

##### 2. CCC: commercial invoices of the code number for the classification of goods in the harmonized commodity description and coding system

113. The Customs Co-operation Council adopted a resolution at its seventy-third and seventy-fourth sessions in which it recommended that exporters refer in the invoice to the Harmonized System (HS) Code number of exported goods as that would help to make classification easier and more uniform. However, it emphasized that the insertion of the number was optional and simply provided information for all parties concerned and, in particular, did not modify the responsibilities of the declarant in the country of importation (CCC Document 35-513).

#### B. Automated trade data procedures

##### 1. ICC: electronic trade data

114. At its meeting on 21 November 1989, the ICC Commission on International Commercial Practice created a working party to look into the legal issues surrounding EDI which could include representatives from other interested ICC Commissions, as well as from the UN/ECE Secretariat, Customs Co-operation Council, UNCITRAL and the EEC.

##### 2. CCC: trade data elements

115. The Customs Co-operation Council (CCC) has recommended that States and autonomous customs territories, whether or not members of the Council, and customs or

economic unions should use EDIFACT data interchange standards in trade data exchange between customs administrations and other trade users (FAL 18/INF.7).

## XI. OTHER TOPICS OF INTERNATIONAL TRADE LAW; CONGRESSES AND PUBLICATIONS

### A. UNCTAD: restrictive business practices

116. The Intergovernmental Group of Experts on Restrictive Business Practices (IGE) held its eighth session from 23 to 27 October 1989 (TD/B/1236-TD/B/RBP/67). The Group reviewed the operation and implementation of the Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices, adopted by the General Assembly in its resolution 35/63 of 5 December 1980. The session considered: (a) a summary of replies received from States on steps taken by them to meet their commitment to the Set of Principles and Rules (TD/B/RBP/59 and Add.1), (b) activities relating to specific provisions of the Set of Principles and Rules (TD/B/RBP/60). Those activities are: (i) studies on restrictive business practices related to the provisions of the Set, on "The concentration of market power through mergers, takeovers, joint ventures and other acquisitions of control, whether of a horizontal, vertical or conglomerate nature, and its effects on international markets, in particular the markets of developing countries"; (ii) technical assistance, advisory and training programmes; (iii) the further revision of the model law or laws for the control of restrictive business practices; (iv) the Handbook on restrictive business practices legislation (TD/B/RBP/58).

117. The Intergovernmental Group also had before it document TD/B/RBP/61: Annual Report 1989 on legislative and other developments in developed and developing countries in the control of restrictive business practices. The Intergovernmental Group requested the UNCTAD secretariat: (i) to prepare the following documentation: (a) An overview of the existing possibilities of supplying, obtaining and making available information on restrictive business practices adversely affecting international trade, in particular the trade and development of developing countries, and of effectively using consultation procedures as provided for in section F, paragraph 4 of the Set, with a view to contributing to the implementation of the agreement reached under paragraph 105(18) of the Final Act of UNCTAD VII; and (b) An assessment of the application and implementation of the Set in the ten-year period of the Set's operation; (ii) to prepare a further compilation of the Handbook on restrictive business practices legislation; (iii) to continue its work on the study of the concentration of market power through mergers, take-overs, joint ventures and other acquisitions of control, and (iv) to continue its work on the model law or laws on restrictive business practices. The ninth session of the Intergovernmental Group will be held from 23 to 27 April 1990. The Second United Nations Conference to review all aspects of the Set of Principles and Rules, mandated by the General Assembly in its resolution 41/167, is scheduled for 26 November to 7 December 1990 (TD/B/RBP/67).

### B. UNIDROIT: hotel keepers contract

118. In 1989, the UNIDROIT Secretariat transmitted to States the text of the 1978 version of the draft Convention and the accompanying Explanatory Report (Study XII—Doc. 50) as well as the revised version of the draft prepared by a sub-committee of the Governing Council with a Secretariat commentary indicating the differences between the two texts (Study XII—Doc. 51). Observations on the new draft have been requested from Governments and, together with those which other international organizations may wish to make, will be circulated for the session of the Committee of Governmental Experts to be held in Rome in October or November 1990.

### C. Council of Europe: Convention on Certain International Aspects of Bankruptcy

119. The Council of Europe has adopted a Convention on Certain International Aspects of Bankruptcy. This Convention contains rules for bankruptcy cases having international aspects on account of the situation of the debtor's assets or of his creditors being spread over different States. When a debtor declared bankrupt in one State has assets in one or more other States, the Convention offers two possibilities: it allows liquidators to exercise, in countries other than the one in which the bankruptcy was opened, certain powers conferred upon them as liquidators (Chapter II); it allows and organizes the opening of secondary bankruptcies (Chapter III). A liquidator who has started the necessary formalities for exercising his powers under Chapter II may have to face a request of a creditor for the opening of a secondary or other local bankruptcy or may, himself, consider at a later stage that the number of creditors or the amount of the assets justify a local bankruptcy and, as a result, the opening of a secondary bankruptcy. When a debtor declared bankrupt has creditors in other States, the Convention allows those creditors to introduce their claims in those other States and therefore, it provides for the information of the creditors and lodgement of their claims in a simplified form (Chapter IV). The Convention is not intended to supersede other multilateral agreements (for example, the Nordic Convention) or bilateral agreements to which a State Party to this Convention is or becomes a party.

### D. Council of Europe: insider trading

120. The draft Convention on Insider Trading reported on in A/CN.9/324, para. 138 was adopted by the Committee of Ministers in January 1989 and opened for signature on 20 April 1989. When considering the draft Convention, and on request of the Commission of the European Communities, an additional Protocol was adopted containing the so-called "disconnection clause" for the member States which are also members of the European Community. The essential aim of the Convention is to create mutual assistance by an exchange of information between contracting parties to enable the supervision of the security market to be carried out effectively and to establish whether persons carrying out certain financial transactions on the stock markets are or are not insiders, which would

show the fraudulent or regular nature of their transactions. The Convention does not require parties to set up control or supervisory bodies for the stockmarkets. However, the co-operation by the exchange of information assumes the existence at national level of an adequate structure both in the field of legislation and in the field of institutions capable of ensuring the collection, the examination and the transmission of information. The headlines of the Convention have been later on incorporated in the Directive issued by the Commission of the European Communities relating to the co-ordination of rules on insider trading.

#### E. ILA: securities regulation

121. The Association is looking into the need for harmonization and co-ordination in the regulation of trans-border financial services, particularly in relation to international capital markets. Initially the Committee is work-

ing on (1) liberalization of financial services in the EEC and (2) the Council of Europe Convention on Insider Trading. A report on those issues will be made at the 64th ILA Conference in Australia in August 1990.

#### F. UNIDROIT: Uniform Law Review

122. The second volume of the 1986 Uniform Law Review and the first issue of the 1987 edition of the Review were published in June 1989. The former contains a select bibliography (Part III) and the customary selection of case law relating to the interpretation and application of uniform law Conventions (Part IV). The 1987/I issue of the Review, among other topics, contains the report on the activities of the Institute in 1986 by the Secretary-General of UNIDROIT and an article entitled "*L'introduction du droit uniforme de Genève sur la lettre de change, le billet à ordre et le chèque dans le droit espagnol*".

## VIII. STATUS OF UNCITRAL TEXTS

### Status of Conventions: note by the Secretariat (A/CN.9/337) [Original: English]

1. At its thirteenth session the Commission decided that it would consider, at each of its sessions, the status of conventions that were the outcome of work carried out by it.\*

2. The present note is submitted pursuant to that decision. The annex hereto sets forth the state of signatures, ratifications, accessions and approvals as of 16 May 1990 to the following conventions: Convention on the Limitation Period in the International Sale of Goods (New York, 1974); Protocol amending the Convention on the Limitation Period in the International Sale of Goods (Vienna, 1980); United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg); United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980); United Nations Convention on International Bills of Exchange and International Promissory Notes (New York, 1988); and Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958). The latter Convention, which has not emanated from the work of the Commission, has been included because of the close interest of the Commission in it, particularly in connection with the Commission's work in the field of international commercial arbitration. In addition, the annex sets forth those jurisdictions that have enacted legislation based on the UNCITRAL Model Law on International Commercial Arbitration.

\*Report of the United Nations Commission on International Trade Law on the work of its thirteenth session, *Official Records of the General Assembly, Thirty-fifth Session, Supplement No. 17 (A/35/17)*, para. 163.

3. Since the most recent report in this series showing the status of conventions as of 16 May 1989 (A/CN.9/325), the Convention on the Limitation Period in the International Sale of Goods received one additional ratification (German Democratic Republic), the Protocol amending that Convention received two additional accessions (Czechoslovakia and German Democratic Republic), the United Nations Convention on Contracts for the International Sale of Goods has received seven additional ratifications or accessions (Byelorussian SSR, Chile, Czechoslovakia, Germany, Federal Republic of, Iraq, Switzerland and Ukrainian SSR), the United Nations Convention on the Carriage of Goods by Sea, 1978 ("Hamburg Rules") has received three additional ratifications or accessions (Burkina Faso, Kenya and Lesotho), the Convention on the Recognition and Enforcement of Foreign Arbitral Awards has received one additional accession (Lesotho), and the United Nations Convention on International Bills of Exchange and International Promissory Notes (New York, 1988) received one signature (Canada). In addition, legislation based on the UNCITRAL Model Law on International Commercial Arbitration has been enacted in addition in Bulgaria, Hong Kong and, within the United States of America, Connecticut and Texas.

4. The names of the States that have ratified or acceded to the conventions since the preparation of the last report are underlined>.

#### 1. Convention on the Limitation Period in the International Sale of Goods (New York, 1974)

<i>State</i>	<i>Signature</i>	<i>Ratification Accession Approval</i>	<i>Entry into force</i>
Argentina		9 October 1981	1 August 1988
Brazil	14 June 1974		
Bulgaria	24 February 1975		
Byelorussian SSR	14 June 1974		
Costa Rica	30 August 1974		
Czechoslovakia	29 August 1975	26 May 1977	1 August 1988
Dominican Republic		23 December 1977	1 August 1988
Egypt		6 December 1982	1 August 1988
<i>German Democratic Republic</i>	14 June 1974	31 August 1989	1 March 1990
Ghana	5 December 1974	7 October 1975	1 August 1988
Hungary	14 June 1974	16 June 1983	1 August 1988
Mexico		21 January 1988	1 August 1988
Mongolia	14 June 1974		
Nicaragua	13 May 1975		
Norway <sup>1</sup>	11 December 1975	20 March 1980	1 August 1988
Poland	14 June 1974		
Ukrainian SSR	14 June 1974		
USSR	14 June 1974		

<i>State</i>	<i>Signature</i>	<i>Ratification Accession Approval</i>	<i>Entry into force</i>
Yugoslavia		27 November 1978	1 August 1988
Zambia		6 June 1986	1 August 1988

Signatures only: 9; ratifications and accessions: 11

#### *Declarations and reservations*

<sup>1</sup>Upon signature Norway declared, and confirmed upon ratification, that in accordance with article 34 the Convention would not govern contracts of sale where the seller and the buyer both had their relevant places of business within the territories of the Nordic States (i.e. Norway, Denmark, Finland, Iceland and Sweden).

### 2. Protocol amending the Convention on the Limitation Period in the International Sale of Goods (Vienna, 1980)

<i>State</i>	<i>Accession</i>	<i>Entry into force</i>
Argentina	19 July 1983	1 August 1988
Czechoslovakia <sup>1</sup>	5 March 1990	1 October 1990
Egypt	6 December 1982	1 August 1988
German Democratic Republic	31 August 1989	1 March 1990
Hungary	16 June 1983	1 August 1988
Mexico	21 January 1988	1 August 1988
Zambia	6 June 1986	1 August 1988

In accordance with articles XI and XIV of the Protocol, the Contracting States to the Protocol are considered to be Contracting Parties to the Convention on the Limitation Period in the International Sale of Goods as amended by the Protocol in relation to one another and Contracting Parties to the Convention, unamended, in relation to the four Contracting Parties to the Convention not yet a Contracting Party to the Protocol, i.e. Dominican Republic, Ghana, Norway and Yugoslavia.

#### *Declarations and reservations*

<sup>1</sup>Upon accession, Czechoslovakia declared that, pursuant to article XII, it did not consider itself bound by article I.

### 3. United Nations Convention on the Carriage of Goods by Sea, 1978 (Hamburg)

<i>State</i>	<i>Signature</i>	<i>Ratification Accession</i>	<i>Entry into force</i>
Austria	30 April 1979		
Barbados		2 February 1981	
Botswana		16 February 1988	
Brazil	31 March 1978		
Burkina Faso		14 August 1989	
Chile	31 March 1978	9 July 1982	
Czechoslovakia <sup>1</sup>	6 March 1979		
Denmark	18 April 1979		
Ecuador	31 March 1978		
Egypt	31 March 1978	23 April 1979	
Finland	18 April 1979		
France	18 April 1979		
Germany, Federal Rep. of	31 March 1978		
Ghana	31 March 1978		
Holy See	31 March 1978		
Hungary	23 April 1979	5 July 1984	
Kenya		31 July 1989	
Lebanon		4 April 1983	
Lesotho		26 October 1989	
Madagascar	31 March 1978		
Mexico	31 March 1978		
Morocco		12 June 1981	
Nigeria		7 November 1988	
Norway	18 April 1979		
Pakistan	8 March 1979		
Panama	31 March 1978		
Philippines	14 June 1978		

<i>State</i>	<i>Signature</i>	<i>Ratification Accession Approval</i>	<i>Entry into force</i>
Portugal	31 March 1978		
Romania		7 January 1982	
Senegal	31 March 1978	17 March 1986	
Sierra Leone	15 August 1978	7 October 1988	
Singapore	31 March 1978		
Sweden	18 April 1979		
Tunisia		15 September 1980	
Uganda		6 July 1979	
United Rep. of Tanzania		24 July 1979	
United States of America	30 April 1979		
Venezuela	31 March 1978		
Zaire	19 April 1979		

Signatures only: 22; ratifications and accessions: 17

Ratifications and accessions necessary to bring the Convention into force: 20

#### *Declarations and reservations*

<sup>1</sup>Upon signing the Convention the Czechoslovak Socialist Republic declared in accordance with article 26 a formula for converting the amounts of liability referred to in paragraph 2 of that article into the Czechoslovak currency and the amount of the limits of liability to be applied in the territory of the Czechoslovak Socialist Republic as expressed in the Czechoslovak currency.

#### 4. United Nations Convention on Contracts for the International Sale of Goods (Vienna, 1980)

<i>State</i>	<i>Signature</i>	<i>Ratification Accession Approval</i>	<i>Entry into force</i>
Argentina <sup>1</sup>		19 July 1983	1 January 1988
Australia		17 March 1988	1 April 1989
Austria	11 April 1980	29 December 1987	1 January 1989
Byelorussian SSR <sup>1</sup>		9 October 1989	1 November 1990
Chile <sup>1</sup>	11 April 1980	7 February 1990	1 March 1991
China <sup>2</sup>	30 September 1981	11 December 1986	1 January 1988
Czechoslovakia <sup>3</sup>	1 September 1981	5 March 1990	1 April 1991
Denmark <sup>4, 5</sup>	26 May 1981	14 February 1989	1 March 1990
Egypt		6 December 1982	1 January 1988
Finland <sup>4, 5</sup>	26 May 1981	15 December 1987	1 January 1989
France	27 August 1981	6 August 1982	1 January 1988
German Democratic Republic	13 August 1981	23 February 1989	1 March 1990
Germany, Federal Rep. of <sup>6</sup>	26 May 1981	21 December 1989	1 January 1991
Ghana	11 April 1980		
Hungary <sup>1, 7</sup>	11 April 1980	16 June 1983	1 January 1988
Iraq		5 March 1990	1 April 1991
Italy	30 September 1981	11 December 1986	1 January 1988
Lesotho	18 June 1981	18 June 1981	1 January 1988
Mexico		29 December 1987	1 January 1989
Netherlands	29 May 1981		
Norway <sup>4, 5</sup>	26 May 1981	20 July 1988	1 August 1989
Poland	28 September 1981		
Singapore	11 April 1980		
Sweden <sup>4, 5</sup>	26 May 1981	15 December 1987	1 January 1989
Switzerland		21 February 1990	1 March 1991
Syrian Arab Republic		19 October 1982	1 January 1988
United States of America <sup>3</sup>	31 August 1981	11 December 1986	1 January 1988
Venezuela	28 September 1981		
Ukrainian SSR <sup>1</sup>		3 January 1990	1 February 1991
Yugoslavia	11 April 1980	27 March 1985	1 January 1988
Zambia		6 June 1986	1 January 1988

Signatures only: 5; ratifications, accessions and approval: 26

#### *Declarations and reservations*

<sup>1</sup>Upon ratifying the Convention the Governments of Argentina, Byelorussian SSR, Chile, Hungary and Ukrainian SSR stated, in accordance with articles 12 and 96 of the Convention, that

any provision of article 11, article 29 or Part II of the Convention that allows a contract of sale or its modification or termination by agreement or any offer, acceptance or other indication of intention to be made in any form other than in writing, would not apply where any party had his place of business in their respective States.

<sup>2</sup>Upon approving the Convention the Government of China declared that it did not consider itself bound by sub-paragraph (b) of paragraph 1 of article 1 and article 11 as well as the provisions in the Convention relating to the content of article 11.

<sup>3</sup>Upon ratifying the Convention the Governments of Czechoslovakia and of the United States of America declared that they would not be bound by sub-paragraph (1)(b) of article 1.

<sup>4</sup>Upon ratifying the Convention the Governments of Denmark, Finland, Norway and Sweden declared in accordance with article 92(1) that they would not be bound by Part II of the Convention (Formation of the Contract).

<sup>5</sup>Upon ratifying the Convention the Governments of Denmark, Finland, Norway and Sweden declared, pursuant to article 94(1) and 94(2), that the Convention would not apply to contracts of sale where the parties have their places of business in Denmark, Finland, Sweden, Iceland or Norway.

<sup>6</sup>Upon ratifying the Convention the Government of the Federal Republic of Germany declared that it would not apply article 1(1)(b) in respect of any State that had made a declaration that that State would not apply article 1(1)(b).

<sup>7</sup>Upon ratifying the Convention the Government of Hungary declared that it considered the General Conditions of Delivery of Goods between Organizations of the Member Countries of the Council for Mutual Economic Assistance to be subject to the provisions of article 90 of the Convention.

##### 5. Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York, 1958)

<i>State</i>	<i>Signature</i>	<i>Ratification Accession</i>
Algeria <sup>1, 2</sup>		7 February 1989
Antigua and Barbuda <sup>1, 2</sup>		2 February 1989
Argentina <sup>1, 2, 7</sup>	26 August 1958	14 March 1989
Australia		26 March 1975
Austria		2 May 1961
Bahrain <sup>1, 2</sup>		6 April 1988
Belgium <sup>1</sup>	10 June 1958	18 August 1975
Benin		16 May 1974
Botswana <sup>1, 2</sup>		20 December 1971
Bulgaria <sup>1, 3</sup>	17 December 1958	10 October 1961
Burkina Faso		23 March 1987
Byelorussian SSR <sup>1, 3</sup>	29 December 1958	15 November 1960
Cameroon		19 February 1988
Canada <sup>4</sup>		12 May 1986
Central African Republic <sup>1, 2</sup>		15 October 1962
Chile		4 September 1975
China <sup>1, 2</sup>		22 January 1987
Colombia		25 September 1979*
Costa Rica	10 June 1958	26 October 1987
Cuba <sup>1, 2, 3</sup>		30 December 1974
Cyprus <sup>1, 2</sup>		29 December 1980
Czechoslovakia <sup>1, 3</sup>	3 October 1958	10 July 1959
Democratic Kampuchea		5 January 1960
Denmark <sup>1, 2</sup>		22 December 1972
Djibouti		14 June 1983
Dominica		28 October 1988
Ecuador <sup>1, 2</sup>	17 December 1958	3 January 1962
Egypt		9 March 1959
El Salvador	10 June 1958	
Finland	29 December 1958	19 January 1962
France <sup>1</sup>	25 November 1958	26 June 1959
German Democratic Republic <sup>1, 2, 3</sup>		20 February 1975
Germany, Federal Rep. of <sup>1</sup>	10 June 1958	30 June 1961
Ghana		9 April 1968
Greece <sup>1, 2</sup>		16 July 1962
Guatemala <sup>1, 2</sup>		21 March 1984
Haiti		5 December 1983
Holy See <sup>1, 2</sup>		14 May 1975

<i>State</i>	<i>Signature</i>	<i>Ratification Accession</i>
Hungary <sup>1, 2</sup>		5 March 1962
India <sup>1, 2</sup>	10 June 1958	13 July 1960
Indonesia <sup>1, 2</sup>		7 October 1981
Ireland <sup>1</sup>		12 May 1981
Israel	10 June 1958	5 January 1959
Italy		31 January 1969
Japan <sup>1</sup>		20 June 1961
Jordan	10 June 1958	15 November 1979
Kenya <sup>1</sup>		10 February 1989
Kuwait <sup>1</sup>		28 April 1978
Lesotho		13 June 1989
Luxembourg <sup>1</sup>	11 November 1958	9 September 1983
Madagascar <sup>1, 2</sup>		16 July 1962
Malaysia <sup>1, 2</sup>		5 November 1985
Mexico		14 April 1971
Monaco <sup>1, 2</sup>	31 December 1958	2 June 1982
Morocco <sup>1</sup>		12 February 1959
Netherlands <sup>1</sup>	10 June 1958	24 April 1964
New Zealand <sup>1</sup>		6 January 1983
Niger		14 October 1964
Nigeria <sup>1, 2</sup>		17 March 1970
Norway <sup>1, 5</sup>		14 March 1961
Pakistan	30 December 1958	
Panama		10 October 1984
Peru		7 July 1988
Philippines <sup>1, 2</sup>	10 June 1958	6 July 1967
Poland <sup>1, 2</sup>	10 June 1958	3 October 1961
Republic of Korea <sup>1, 2</sup>		8 February 1973
Romania <sup>1, 2, 3</sup>		13 September 1961
San Marino		17 May 1979
Singapore <sup>1</sup>		21 August 1986
South Africa		3 May 1976
Spain		12 May 1977
Sri Lanka	30 December 1958	9 April 1962
Sweden	23 December 1958	28 January 1972
Switzerland <sup>1</sup>	29 December 1958	1 June 1965
Syrian Arab Republic		9 March 1959
Thailand		21 December 1959
Trinidad and Tobago <sup>1, 2</sup>		14 February 1966
Tunisia <sup>1, 2</sup>		17 July 1967
Ukrainian SSR <sup>1, 3</sup>	29 December 1958	10 October 1960
USSR <sup>1, 3</sup>	29 December 1958	24 August 1960
United Kingdom <sup>1</sup>		24 September 1975
United Republic of Tanzania <sup>1</sup>		13 October 1964
United States of America <sup>1, 2</sup>		30 September 1970
Uruguay		30 March 1983
Yugoslavia <sup>1, 2, 6</sup>		26 February 1982

Signatures only: 2; ratifications and accessions: 83

#### *Declarations and reservations*

(Excludes territorial declarations and certain other reservations and declarations of a political nature)

<sup>1</sup>State will apply the Convention to recognition and enforcement of awards made in the territory of another Contracting State.

<sup>2</sup>State will apply the Convention only to differences arising out of legal relationships whether contractual or not which are considered as commercial under the national law.

<sup>3</sup>With regard to awards made in the territory of non-contracting States, State will apply the Convention only to the extent to which these States grant reciprocal treatment.

<sup>4</sup>The Government of Canada has declared that Canada will apply the Convention only to differences arising out of legal relationships, whether contractual or not, which are considered as commercial under the laws of Canada, except in the case of the Province of Quebec where the law does not provide for such limitation.

<sup>5</sup>State will not apply the Convention to differences where the subject matter of the proceedings is immovable property situated in the State, or a right in or to such property.



<sup>6</sup>State will apply the Convention only to those arbitral awards which were adopted after the coming of the Convention into effect.

<sup>7</sup>The present Convention should be construed in accordance with the principles and rules of the National Constitution in force or with those resulting from reforms mandated by the Constitution.

\*Ratification declared unconstitutional by the Supreme Court on October 26, 1988.

#### 6. United Nations Convention on International Bills of Exchange and International Promissory Notes (New York, 1988)

<i>State</i>	<i>Signature</i>	<i>Ratification Accession</i>	<i>Entry into force</i>
Canada	7 December 1989		
Ratifications and accessions necessary to bring the Convention into force: 10			

#### 7. UNCITRAL Model Law on International Commercial Arbitration (1985)

Legislation based on the UNCITRAL Model Law on International Commercial Arbitration has been enacted in Australia, Bulgaria, Canada (by the Federal Parliament and by the Legislatures of all Provinces and Territories), Cyprus, Hong Kong, Nigeria and, within the United States of America, California, Connecticut and Texas).

## IX. TRAINING AND ASSISTANCE

### Training and assistance: note by the Secretariat (A/CN.9/335) [Original: English]

1. At the twentieth session of the Commission (1987) it was "noted that training and assistance was an important activity of the Commission and should be given a higher priority than it had in the past".<sup>1</sup>

2. Accordingly, the secretariat has endeavoured to devise a more extensive programme of training and assistance than had been previously carried out. The programme is designed primarily to acquaint lawyers, scholars and government officials, particularly from developing countries, with the work of UNCITRAL and with the legal texts that have emanated from its work and to promote the adoption and use of those texts. This note describes the developments following the twenty-second session of the Commission (1989) and discusses possible future activities.

#### I. INTERNATIONAL, REGIONAL AND NATIONAL SEMINARS

##### A. Seminar on international trade law and arbitration in India (Delhi, 12 to 16 October 1989)

3. The seminar on international trade law and arbitration held in Delhi was hosted by the Indian Council of Arbitration and sponsored by the Asian-African Legal Consultative Committee (AALCC), UNCITRAL, United Nations Conference on Trade and Development (UNCTAD) and International Institute for the Unification of Private Law (UNIDROIT). The purpose of the seminar was to promote awareness of the conventions and other legal texts prepared by the sponsoring organizations in the Asian member States of AALCC.

4. AALCC made all of the arrangements for the holding of the seminar, including the issuing of invitations. UNCITRAL paid for air travel expenses of some of the participants and some of the administrative costs of holding the seminar. The majority of the participants were from the embassies of the respective States in Delhi. In addition, in exchange for permitting the use of its facilities without charge, the Indian Council of Arbitration was permitted to invite up to 60 of its members to attend the seminar.

5. Lectures were given by members of the secretariats of the three co-sponsoring organizations on the texts on inter-

national trade law prepared by their organizations. In the case of UNCITRAL, the lectures were given on international sale of goods, the carriage of goods by sea, international commercial arbitration and international bills of exchange and international promissory notes.

##### B. Seminar in Guinea (Conakry, 27 to 29 March 1990)

6. A two-day seminar was hosted by the Government of Guinea and organized by the Ministry of Foreign Affairs. The purpose of the seminar was to explain the UNCITRAL legal texts to a broad cross-section of the local legal community.

7. Approximately 120 participants from the interested ministries, the university and the private sector attended the seminar. The lectures were given in French by two lecturers, one of whom was a member of the secretariat.

##### C. Seminar on International Trade Law in USSR (Moscow, 17 to 21 April 1990)

8. As announced to the twenty-second session of the Commission (1989), a seminar on the work of the Commission was held in Moscow from 17 to 21 April 1990 for participants from developing countries (A/44/17, para. 285). The School of International Private and Civil Law and the School of International Business of the Moscow State Institute for Foreign Relations hosted the seminar. The seminar was financed from a trust fund established by the Soviet Union with the United Nations Development Programme for training of individuals from developing countries. Twenty-one participants from developing countries attended the seminar.

9. The lectures were given in English or in Russian with simultaneous interpretation into the other language. They were given by six lecturers from the Soviet Union, six non-Soviet lecturers who have been associated with the Commission as delegates and two members of the secretariat.

10. The lectures at the seminar included the following topics: UNCITRAL: its history, current activities and plans for the future; international sale of goods; international bills of exchange and international promissory notes; carriage of goods by sea, international commercial arbitration and restructuring of the foreign economic relations of the USSR and its legal aspects. The lectures were followed by periods of questions and discussions.

<sup>1</sup>Report of the United Nations Commission on International Trade Law on the work of its twentieth session, *Official Records of the General Assembly, Forty-second Session, Supplement No. 17 (A/42/17)*, para. 335.

#### D. Other seminars, conferences, courses or professional meetings

11. Members of the UNCITRAL secretariat participated as speakers in other seminars, conferences or professional meetings where UNCITRAL legal texts were presented for examination and discussion. The UNCITRAL secretariat was represented at the following seminars, conferences, courses or professional meetings: (i) course on "International Transport of Goods: Contracts and Insurance" organized by the International Development Law Institute (Rome, December 6-19, 1988), United Nations Convention on the Carriage of Goods by Sea, 1978 (the Hamburg Rules); (ii) course on international payment organized by the Inter-University Centre of Postgraduate Studies (Dubrovnik, 20-25 March 1989), United Nations Convention on International Bills of Exchange and International Promissory Notes and the Legal Guide on Electronic Funds Transfers; (iii) course on "Development Assistance Agency Procurement Guidelines" organized by the International Development Law Institute (Rome, 9-12 May 1989), Public Procurement; (iv) seminar on international commercial arbitration organized by Asian-African Legal Consultative Committee (AALCC) (Kuala Lumpur, 4-5 July 1989), UNCITRAL Model Law on International Commercial Arbitration; (v) the Eighth Meeting of Latin American Banking Lawyers (Montevideo, 5-7 July 1989), United Nations Convention on International Bills of Exchange and International Promissory Notes; (vi) course organized by the United Nations Institute for Training and Research (UNITAR) under the United Nations-UNITAR Fellowship Programme (Hague, 19-21 July 1989), UNCITRAL Arbitration Rules and UNCITRAL Model Law on International Commercial Arbitration; (vii) seminar sponsored by the Institute for Maritime Law and Maritime Trade Law (University of Hamburg, 29-30 September 1989), Draft Convention on the Liability of Operators of Transport Terminals in International Trade; (viii) the third Euro-Arab Arbitration Congress sponsored by the Euro-Arab Chambers of Commerce in co-operation with the Federation of Jordanian Chambers of Commerce (Amman, 23-25 October 1989), UNCITRAL Model Law on International Commercial Arbitration; and (ix) seminar on Current Legal Issues Affecting Central Banks organized by the International Monetary Fund (Washington, D.C., 26 April 1990), UNCITRAL's recent work of interest to legal advisers of central banks.

#### II. THE INTERNSHIP PROGRAMME

12. The programme is designed to enable persons who have recently obtained a law degree, or who have nearly completed their work towards such a degree, the opportunity to serve as interns in the International Trade Law Branch. Interns are assigned specific tasks in connection with projects being worked on by the secretariat. Persons participating in the programme are able to become familiar with the work of UNCITRAL and to increase their knowledge of specific areas in the field of international trade law. In addition, the secretariat occasionally accommodates scholars and legal practitioners for a limited period of time.

13. Each year an average of four interns have been accepted. In response to a questionnaire sent by the secretariat to all persons that served as interns, the general feeling expressed was that the programme provides an excellent opportunity for interns to learn and broaden their knowledge in the field of international trade law and thereby appreciate better the work of UNCITRAL.

14. The majority of the interns, so far, have come from developed countries. While the opportunity for internship with the secretariat is available to all candidates, and an increasing number of enquiries have been received from candidates from developing countries, only a small number of interns from developing countries have participated because of lack of financial support. The United Nations is not in a position to provide financial assistance to interns. Normally the interns provide their own funds for travel and subsistence during the period of internship.

15. The United Nations Institute for Training and Research (UNITAR), which conducts the United Nations/UNITAR fellowship programme, has awarded grants to interns to receive training with the Office of Legal Affairs. UNITAR fellowships were awarded to two interns to serve with the UNCITRAL secretariat in 1981 and 1984.

#### III. POSSIBLE FUTURE ACTIVITIES

16. The secretariat expects to intensify even further its efforts to organize or co-sponsor seminars and symposia on international trade law, especially for developing countries.

##### A. The fourth UNCITRAL Symposium

17. As announced to the twenty-second session of the Commission, in view of the success of the third UNCITRAL symposium held at Vienna, it is intended to organize the fourth UNCITRAL Symposium on International Trade Law on the occasion of the twenty-fourth session of the Commission, in 1991 (A/44/17, para. 283).

##### B. Tentative plans for regional seminars

18. It is hoped that regional seminars would be held, where possible, with regional organizations in developing countries in different parts of the world. Regional seminars require fairly large amounts of funds to cover travel and other expenses of participants and lecturers. Such seminars provide excellent opportunity for participants from a given region to address common legal problems faced by the member States.

19. Tentative plans have been made with the Comisión Centroamericana de Transporte Marítimo (COCATRAM) to sponsor a series of seminars on the Hamburg Rules in each of the member States of COCATRAM. The plans are for the seminars to be held in July or August. A member of the UNCITRAL secretariat would be among the lecturers.

20. A seminar for the seventeen francophone States of North and West Africa is planned to be held in the fourth quarter of 1990. The seminar will be organized on the pattern of the Lesotho Seminar in July 1988.<sup>2</sup> The plans are to invite three participants from each of the participating States. The participants will be chosen from the ministries interested in the work of the Commission, the universities or the private sector.

21. A location for the seminar has not as yet been fixed. A Government in the region has been asked to host the seminar, but has not as yet replied. The estimated budget for this seminar is \$US 150,000. The Government of France has made a contribution of approximately \$US 77,000 and the Government of Luxemburg a contribution of \$US 500 to cover the expenses of the seminar. It is hoped that the remainder of the estimated budget will be covered by additional contributions specifically intended for the seminar.

22. The UNCITRAL secretariat is currently holding discussions with the secretariat of the South Pacific Bureau for Economic Co-operation (SPEC) with a view to sponsoring a seminar in the Pacific region. The initial response has been encouraging and the secretariat hopes to co-sponsor a seminar with SPEC in the region sometime in 1991.

### C. Request for national seminars

23. The UNCITRAL programme of training and assistance and participation of members of the UNCITRAL secretariat in other seminars and conferences have helped to bring about awareness of the work of the Commission and its legal texts among many developing countries. A number of enquiries relating to the training and assistance programme of the Commission have been received from secretariats of regional organizations, particularly from developing countries. In addition, the secretariat is increasingly receiving requests from developing countries for national seminars on UNCITRAL legal texts similar to the seminar held in Conakry (see paragraphs 6-7, above).

24. The main purpose of such seminars is to inform a wide cross-section of the community in a given country of the UNCITRAL legal texts to help build a broad consensus in favour of the adoption of some or all of the texts. National seminars tend to be cost effective in that participants attend at little or no cost. Funds are required to cover only the travel and other expenses of the lecturers. It is hoped that it will be possible to organize a series of national seminars in neighbouring countries in various regions so as to minimize the costs in time of the lecturers and in money.

### D. Technical assistance

25. The awareness of the UNCITRAL legal texts among many countries, in particular developing countries, is coupled with increasing requests for technical assistance from individual Governments or regional organizations.

The secretariat has been requested on a number of occasions to consult with individual countries during their consideration of one of the UNCITRAL texts. This has normally consisted of comments in writing on reports and draft legislation, preparation of Accession Kits or a comparison of the UNCITRAL legal text with the existing law of a given country and a discussion of its advantages and disadvantages in comparison to the existing law. It has also consisted of travel to the country in question to consult with relevant officials.

26. Requests from regional organizations range from review of laws of member States with a view to harmonization and possible unification to provision of a consultant. For example, recently the Preferential Trade Area for Eastern and Southern African States (PTA) requested a consultant for a year to assist in the establishment of the arbitration system for the whole region using the UNCITRAL Arbitration Rules and the UNCITRAL Model Law on International Commercial Arbitration.

27. Requests for such assistance have placed additional work on the secretariat. Nevertheless, it is believed that every effort should be made to meet those requests, both because of their relationship to the adoption of the texts prepared by UNCITRAL and because of their importance to the development of international trade law. There are clear indications that the requests for such assistance will continue to increase, especially in the light of the growing number of UNCITRAL legal texts.

## IV. FINANCIAL AND ADMINISTRATIVE CONSIDERATIONS

28. In order to carry out the programme on training and assistance effectively, an adequate source of funds needs to be assured. No funds are provided in the regular budget for training and assistance activities, whether in order to train young lawyers and scholars or to promote the adoption of the UNCITRAL texts (except for an allocation of a small amount of staff time). As a result, funding for travel of participants or lecturers must normally be met from voluntary contributions to the UNCITRAL Symposia Trust Fund. Accordingly, the Commission at its twenty-second session in 1989 recalled the invitation of the General Assembly in paragraph 5(c) of resolution 43/166 of 9 December 1988 to Governments, the relevant United Nations organs, organizations, institutions and individuals to make voluntary contributions to the United Nations Commission on International Trade Law Symposia Trust Fund for the financing of such activities. It also recalled its earlier invitation that such voluntary contributions be made, where possible, on an annual basis (A/44/17, para. 287).

29. In addition to assured financial resources, an effective programme of training and technical assistance requires adequate administrative resources. So far, the administrative requirements of the programme have been met by the existing staff of the secretariat. It appears that the programme carried out during the last two years has been the maximum that can be accommodated with the current staff. Moreover, the secretariat is of the view that it has not been able to remain in contact with participants

<sup>2</sup>This seminar was reported in a note by the secretariat submitted to the twenty-second session in 1989, A/CN.9/323, paras. 2-11.

in the various seminars as effectively as would be desired. Such continuing contact with participants is important to gain maximum value from the seminars. Some relief is expected in the near future with the appointment of a Junior Professional Officer furnished by the Government of Italy, one of whose duties will be the organization and follow-up to the training and assistance activities of the secretariat.

30. The Commission may wish to express its appreciation to those States and institutions that have contributed to the Commission's programme of training and assistance by contribution of funds or staff or by the hosting of seminars. The Commission may also wish to request the secretariat to continue its efforts to secure the financial, personnel and administrative support necessary to place the programme on a firm and continuing basis.

## X. UNITED NATIONS DECADE OF INTERNATIONAL LAW

### United Nations Decade of International Law: note by the Secretariat (A/CN.9/338) [Original: English]

1. The General Assembly, at its forty-fourth session, adopted a resolution declaring the period 1990 to 1999 as the United Nations Decade of International Law (resolution 44/23 of 17 November 1989). A copy of the resolution is annexed hereto.

2. The Commission may wish to consider whether, pursuant to paragraph 3 of the resolution, it wishes to express any views on the programme for the Decade or on appropriate action to be taken during the Decade, e.g., in the area of the settlement of transnational disputes arising in international trade or on other aspects of international trade law.

#### Annex

[Original: Arabic, Chinese, English, French, Russian and Spanish]

#### 44/23. United Nations Decade of International Law

##### *The General Assembly,*

*Recognizing* that one of the purposes of the United Nations is to maintain international peace and security, and to that end to bring about by peaceful means, and in conformity with the principles of justice and international law, adjustment or settlement of international disputes or situations which might lead to a breach of the peace,

*Recalling* the Declaration on Principles of International Law concerning Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations<sup>1</sup> and the Manila Declaration on the Peaceful Settlement of International Disputes,<sup>2</sup>

*Recognizing* the role of the United Nations in promoting greater acceptance of and respect for the principles of international law and in encouraging the progressive development of international law and its codification,

*Convinced* of the need to strengthen the rule of law in international relations,

*Stressing* the need to promote the teaching, study, dissemination and wider appreciation of international law,

*Noting* that, in the remaining decade of the twentieth century, important anniversaries will be celebrated that are related to the adoption of international legal documents, such as the centenary of the first International Peace Conference, held at The Hague in 1899, which adopted the Convention for the Pacific Settlement of International Disputes<sup>3</sup> and created the Permanent Court of Arbitration, the fiftieth anniversary of the signing of the Charter of the United Nations and the twenty-fifth anniversary of the adoption of the Declaration on Principles of International Law concerning Friendly Relations and Co-operation among States in accordance with the Charter of the United Nations,

1. *Declares* the period 1990-1999 as the United Nations Decade of International Law;

2. *Considers* that the main purposes of the Decade should be, *inter alia*:

(a) To promote acceptance of and respect for the principles of international law;

(b) To promote means and methods for the peaceful settlement of disputes between States, including resort to and full respect for the International Court of Justice;

(c) To encourage the progressive development of international law and its codification;

(d) To encourage the teaching, study, dissemination and wider appreciation of international law;

3. *Requests* the Secretary-General to seek the views of Member States and appropriate international bodies, as well as of non-governmental organizations working in the field, on the programme for the Decade and on appropriate action to be taken during the Decade, including the possibility of holding a third international peace conference or other suitable international conference at the end of the Decade, and to submit a report thereon to the Assembly at its forty-fifth session;

4. *Decides* to consider this question at its forty-fifth session in a working group of the Sixth Committee with a view to preparing generally acceptable recommendations for the Decade;

5. *Also decides* to include in the provisional agenda of its forty-fifth session the item entitled "United Nations Decade of International Law".

60th plenary meeting  
17 November 1989

<sup>1</sup>Resolution 2625 (XXV), annex.

<sup>2</sup>Resolution 37/10, annex.

<sup>3</sup>See Carnegie Endowment for International Peace, *The Hague Conventions and Declarations of 1899 and 1907* (New York, Oxford University Press, 1915).

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